

1 FEDERAL TRADE COMMISSION

2 I N D E X (PUBLIC RECORD)

3

4 WITNESS: DIRECT CROSS REDIRECT RECROSS

5 Bresnahan 1092 (SP) 1222

6

7 EXHIBITS FOR ID IN EVID

8 Commission

9 None

10 Schering

11 None

12 Upsher

13 None

14

15 OTHER EXHIBITS REFERENCED PAGE

16 Commission

17 CX 283 1104

18 CX 341 1117

19 CX 558 1115

20 CX 1510 1233

21 Schering

22 SPX 836 1133

23 SPX 1058 1167

24 SPX 2004 1097

25 SPX 2006 1093

For The Record, Inc.
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1	Schering	
2	SPX 2007	1098
3	Upsher	
4	None	
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For The Record, Inc.
Waldorf, Maryland
(301) 870-8025

1 FEDERAL TRADE COMMISSION

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3 In the Matter of:)

4 SCHERING-PLOUGH CORPORATION,)

5 a corporation,)

6 and)

7 UPSHER-SMITH LABORATORIES,) File No. D09297

8 a corporation,)

9 and)

10 AMERICAN HOME PRODUCTS,)

11 a corporation.)

12 -----)

13

14 Wednesday, January 30, 2002

15 11:30 a.m.

16 TRIAL VOLUME 6

17 PART 1

18 PUBLIC RECORD

19 BEFORE THE HONORABLE D. MICHAEL CHAPPELL

20 Administrative Law Judge

21 Federal Trade Commission

22 600 Pennsylvania Avenue, N.W.

23 Washington, D.C.

24

25 Reported by: Susanne Bergling, RMR

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1 P R O C E E D I N G S

2 - - - - -

3 JUDGE CHAPPELL: We're back on the record,
4 docket 9297.

5 Ms. Bokat, did you have something?

6 MS. BOKAT: Good morning, Your Honor. Before
7 we go into the witness examination, may I raise a
8 couple of transcript corrections and a scheduling
9 question, please?

10 JUDGE CHAPPELL: Yes, and I'm not sure I made
11 it clear, but if you have stipulations, I'll allow you
12 to read them into the record rather than file them in
13 writing.

14 MS. BOKAT: Right. We reached a stipulation,
15 "we" being counsel for the three parties, yesterday on
16 two parts of the transcript. The first is that portion
17 of January 22nd, which was a segment of the prehearing
18 conference, and I had mentioned a problem with some
19 exhibit numbers.

20 JUDGE CHAPPELL: Right.

21 MS. BOKAT: So, all three of the parties have
22 agreed that on page 279, beginning at line 16, it
23 should read:

24 "JUDGE CHAPPELL: These exhibits you just
25 listed, Mr. Meier, 165, 166, 167, 170, 467, 744, are

1 those all the AHP exhibits?"

2 And then the second stipulation has to do with
3 one portion of yesterday morning's transcript that
4 occurred on our realtime at approximately 10:52 a.m. --

5 JUDGE CHAPPELL: Are you doing something in
6 writing to give the court reporter just so she will
7 have that? I mean, I can rule on the record that it's
8 approved, but do you have something prepared to give
9 the court reporter?

10 MS. BOKAT: No, I'm sorry, I misunderstood. I
11 thought if we had a stipulation we could do it orally,
12 but we could certainly prepare something in writing to
13 follow up.

14 JUDGE CHAPPELL: We will ask her. If this is
15 sufficient, it's fine with me. I just want to make
16 sure that she has what she needs to do, but you've
17 concluded the first change, right?

18 MS. BOKAT: Yes, Your Honor.

19 JUDGE CHAPPELL: That's granted. Let's go to
20 the next one.

21 MS. BOKAT: The second one occurred yesterday
22 morning at approximately 10:52 a.m. at line 38 --

23 JUDGE CHAPPELL: Excuse me, 2:52 a.m.? I know
24 we were here late, but --

25 MS. BOKAT: I meant to say 10:52 a.m. yesterday

1 morning.

2 JUDGE: 10:52, okay.

3 MS. BOKAT: It reads the word "press," P R E S
4 S, instead it should be "price," and again, counsel for
5 all three parties have agreed to that correction.

6 JUDGE CHAPPELL: Okay, that's granted.

7 MS. BOKAT: Would the court reporter like us to
8 follow up with something in writing on that?

9 THE REPORTER: No, not for those two. Can we
10 go off the record?

11 (Discussion off the record.)

12 MS. BOKAT: Then one scheduling point, Your
13 Honor. Our plan has been that after Dr. Bresnahan's
14 testimony is concluded, we would then proceed with Dr.
15 Levy, who is here in town and, in fact, in the
16 courtroom, followed by Lawrence Rosenthal of Andrx
17 Corporation. That's still our plan. We've got a
18 couple of scheduling problems.

19 Dr. Levy has a family commitment Friday
20 afternoon, so he can testify all day Thursday. Mr.
21 Rosenthal will be available and can testify Friday, but
22 he has a problem next week. So, my proposal would be,
23 after the conclusion of Dr. Bresnahan, we put Dr. Levy
24 on, and he testify on Thursday, and then on Friday we
25 put on Mr. Rosenthal. If Dr. Levy doesn't conclude on

1 Thursday, he will come back Tuesday to conclude.

2 Now, I've conferred with opposing counsel on
3 that, and I'll try and summarize where I think we are
4 and hopefully they'll jump in if I misstate anything.

5 JUDGE CHAPPELL: I'm sure they will.

6 MS. BOKAT: They did not want their cross of
7 Dr. Levy interrupted. So, if after his direct on
8 Thursday it looks like they could complete cross, they
9 would be willing to go ahead. Otherwise, we might have
10 to have him come back -- him, Dr. Levy -- come back
11 Tuesday for cross. All of that obviously would be with
12 the indulgence of the Court.

13 JUDGE CHAPPELL: So, then, what may happen is
14 if Dr. Levy finishes Thursday, tomorrow, then you're
15 not prepared to present another live witness under this
16 agreement, they're not going to start their cross. Is
17 that -- do I understand that?

18 MS. SHORES: Well, I'll let complaint counsel
19 address that. I think it's highly unlikely that Dr.
20 Levy, what with -- you know, anticipating some redirect
21 of Dr. Bresnahan, that -- I think it's highly unlikely
22 that Dr. Levy would finish his direct examination and
23 for us to complete our cross examination on Thursday.
24 I think that's highly unlikely.

25 JUDGE CHAPPELL: Do you anticipate he will be

1 on direct eight or nine hours or do you have -- what's
2 your ballpark?

3 MS. BOKAT: I think our ballpark is four hours,
4 I believe, on direct for Dr. Levy.

5 JUDGE CHAPPELL: Let me have respondents state
6 what you don't object to regarding this witness.

7 MS. SHORES: Your Honor, speaking for
8 Schering-Plough, we do not object to Dr. Levy's direct
9 examination either being completed this week with cross
10 to follow next week or his direct examination being
11 interrupted by the weekend and completed next week.
12 What we on behalf of Schering object to is for our
13 cross examination to be split up by a weekend with
14 another witness.

15 JUDGE CHAPPELL: Okay. And if I understood you
16 right, Ms. Bokar -- that's okay, you may be seated --
17 Upsher, did you want to -- Mr. Curran?

18 MR. CURRAN: I would just like to add on behalf
19 of Upsher-Smith, we were pleased to accommodate the
20 schedule of the witnesses. We trust that the Court can
21 hold in abeyance judgment on Dr. Levy's opinions until
22 our crosses are completed, even if there's a -- if
23 there's a couple days duration in between.

24 JUDGE CHAPPELL: Okay. So, you don't object to
25 beginning cross and stopping in the middle of it?

1 MR. CURRAN: No, I do object to beginning cross
2 and stopping in the middle. I think it's much more
3 likely that Dr. Levy will conclude his direct
4 examination on Thursday, cross will not even begin, and
5 then we will have Mr. Rosenthal Friday, direct and
6 cross, and then resume on Tuesday with the Levy cross
7 from start to finish.

8 JUDGE CHAPPELL: If the estimate is close, do
9 one of the respondents think you can do your cross in
10 four hours? Are you planning on more than that?

11 MS. SHORES: Your Honor, it's awfully hard to
12 say given that I don't know what his testimony is going
13 to be. I guess I would just -- I wouldn't want to be
14 held committed to that. Certainly if the direct is
15 four hours, I wouldn't anticipate in the normal course
16 that my cross would be longer than his direct. I can
17 make that representation.

18 JUDGE CHAPPELL: Okay. And did I hear you to
19 say this witness Rosenthal is not available Thursday?

20 MS. BOKAT: That is correct, Your Honor. He's
21 available Friday. One thing we could do, Your Honor,
22 if we have some down time might be to fill in with more
23 readings.

24 JUDGE CHAPPELL: Okay, would the respondents
25 agree to allow some excerpt reading from depositions

1 rather than beginning your cross?

2 MS. SHORES: Absolutely, Your Honor.

3 MR. CURRAN: Yes, Your Honor.

4 JUDGE CHAPPELL: Okay. So, to make sure I
5 understand this, there's no objection to Mr. Levy
6 testifying, the Government finishes the direct exam, if
7 we're not at a stopping point during the day, because I
8 am not going to hold you to the four hours, I've done
9 this before. Then the Government will fill the time
10 with presenting part of their -- more of their case in
11 chief, which will be I assume deposition excerpts or --
12 I'm not -- you know, whatever you want to do. And then
13 we will break, cross will begin with Dr. Levy no sooner
14 than Tuesday morning.

15 MS. SHORES: That's fine, Your Honor.

16 JUDGE CHAPPELL: Is that acceptable?

17 MS. BOKAT: Yes. I appreciate the cooperation
18 of respondents' counsel and the indulgence of the
19 Court.

20 JUDGE CHAPPELL: Then if that's a motion, it's
21 granted. If it's a request, it's accepted.

22 Okay, anything else?

23 MS. BOKAT: Not from complaint counsel, Your
24 Honor.

25 JUDGE CHAPPELL: I couldn't get anybody to cool

1 off the courtroom, but I will offer free paper towels
2 to wipe your brow if it's as hot as it was yesterday at
3 4:00.

4 MR. CURRAN: Your Honor, I would like to raise
5 one related issue. I believe that Your Honor has been
6 provided with a copy of Mr. Rosenthal's transcript from
7 the Hoechst-Andrx matter?

8 JUDGE CHAPPELL: I have.

9 MR. CURRAN: Obviously I was given a copy of
10 the cover letter but not the attachment. I would just
11 like to note that based on the statement accompanying
12 complaint counsel's trial brief, Mr. Rosenthal will be
13 providing testimony on his direct examination relating
14 to the entry of generics generally in a situation where
15 there's a branded drug already on the market.

16 So, if it would be of some assistance to you,
17 I would just like to note that anything in that
18 transcript that you'll be reviewing in camera that
19 relates to the effect on the market upon generic entry,
20 I would suggest is relevant and is something we ought
21 to have in anticipation of his cross examination.

22 JUDGE CHAPPELL: I'll take that into
23 consideration, Mr. Curran. What I had thought about or
24 what my plan is, I am going to wait and hear what the
25 witness says on direct, and then I am going to review

1 the deposition transcript in camera so I can have more
2 context to what he's saying what I think needs to be
3 redacted and not redacted.

4 Thank you.

5 MR. CURRAN: Thank you, Your Honor.

6 JUDGE CHAPPELL: Anything else before we get
7 started?

8 Dr. Bresnahan, I remind you you are still under
9 oath.

10 Mr. Nields, you may proceed with cross
11 examination for Schering-Plough.

12 MR. NIELDS: Thank you, Your Honor. I should
13 mention before I begin that I have provided the witness
14 and the Court and opposing counsel three binders of
15 documents, and we certainly won't be looking at all of
16 them, but there may be some as we go forward that we
17 will be, and I will try to make the appropriate
18 references to where they can be found at the
19 appropriate time.

20 JUDGE CHAPPELL: I think you'll need to bend
21 that microphone up, Mr. Nields.

22 MR. NIELDS: Is that better, Your Honor?

23 JUDGE CHAPPELL: Yes, thank you, you may
24 proceed.

25 Whereupon--

1 TIMOTHY F. BRESNAHAN

2 a witness, called for examination, having previously
3 been duly sworn, was examined and testified further as
4 follows:

5 CROSS EXAMINATION

6 BY MR. NIELDS:

7 Q. Good morning.

8 A. Good morning, Mr. Nields.

9 Q. Professor, I am going to start off by asking
10 you some questions about your opinion that Schering, in
11 fact, paid Upsher for delay. On direct, you said that
12 that opinion was supported by deposition testimony by
13 participants in the negotiation. Do you recall that?

14 A. I do.

15 Q. And in fact, in your report you have a separate
16 section headed Direct Evidence in which you conclude
17 that there is direct evidence that Schering purchased
18 delay from Upsher, and then you proceed to discuss the
19 deposition testimony of the participants in the
20 negotiation.

21 Do you recall that?

22 A. I do.

23 Q. And the testimony you discuss is testimony from
24 Mr. Hoffman, Mr. Driscoll, Mr. Troup and Mr. Kapur. Do
25 you recall that?

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1 A. I think that's right, yes.

2 Q. Isn't it true, Professor, that each one of
3 these people testified that Schering refused to pay
4 Upsher to stay off the market?

5 A. Yes, that's right.

6 Q. Let's take a look at that, if we could. I'm
7 starting off with an excerpt from the testimony of Mr.
8 Hoffman, and he, as we recall, is the -- in charge of
9 litigation and antitrust at Schering. This testimony
10 was given July 25th in the year 2000. It is SPX 2006.

11 A. Mr. Nields, I see it, but is that also in one
12 of the binders?

13 Q. It is in binder 2, tab 5.

14 A. There is still that slight rollover here.

15 Q. Take your time. Take a look at binder 2, tab
16 5, page 35.

17 A. Yes, thank you.

18 Q. There, Mr. Hoffman testifies as follows:

19 "QUESTION: Was there any discussion of
20 Schering making payments to Upsher-Smith in order to
21 settle the lawsuit?

22 "ANSWER: I don't recall that was asked for
23 directly. I recall that it was my sense that that was
24 something they thought we ought to do -- thought we
25 should do, excuse me, and I recall telling them we were

1 not going to do that."

2 And then it goes on further down the page:

3 "QUESTION: Was there discussion of how much
4 money Upsher-Smith wanted to settle the lawsuit?

5 "ANSWER: I don't recall any discussion of any
6 amount that Upsher-Smith wanted. I do recall that the
7 consultant they brought was doing some sort of analysis
8 of how much we stood to lose if we lost the lawsuit.
9 And I believe that's what led me to believe they
10 thought it would be an appropriate thing for us to pay
11 them to settle the lawsuit. And I told them we would
12 not do that."

13 Do you call that direct evidence that Schering
14 paid Upsher for delay?

15 A. No, I don't.

16 Q. Did Mr. Hoffman in any other part of his
17 testimony retract that statement in any way?

18 A. Mr. Hoffman did not retract literally this
19 statement, but he did refer elsewhere to payment in
20 connection with the licenses.

21 Q. He testified, did he not, that he told Upsher
22 that he wouldn't pay for delay, he wouldn't pay for
23 them to stay off the market, but he would pay for a
24 license. Is that correct?

25 A. No, not quite. The -- there were three parts

1 in there, and as I recall the first two parts are
2 right, but the -- I don't think the third part is -- is
3 right.

4 Q. I'll amend the third part and see if we can get
5 that right. He told Upsher that he would be willing to
6 do a separate deal so long as it stood on its own two
7 feet. Is that correct?

8 A. I believe he also said that.

9 JUDGE CHAPPELL: Mr. Nields, excuse me, I think
10 we have more than one Mr. Hoffman, so for the record,
11 let's be sure which Mr. Hoffman we're talking about
12 here.

13 MR. NIELDS: John Hoffman, Your Honor, John F.
14 Hoffman, the head of litigation and antitrust at
15 Schering.

16 JUDGE CHAPPELL: Thank you.

17 THE WITNESS: Yeah, that was who I thought you
18 were talking about in your earlier questions.

19 BY MR. NIELDS:

20 Q. Okay, let's actually take a look at his
21 testimony. This is at page 36:

22 "QUESTION: Was anything else discussed at this
23 meeting in the law department conference room about
24 settlement of the lawsuit?

25 "ANSWER: Not that I recall. That's not -- let

1 me explain.

2 "I recall Ian Troup saying that while he
3 understood the construct under which we were going to
4 settle the lawsuit, that Upsher-Smith had a need for
5 income. And it would have to be -- we'd have to do
6 some other sort of deal so they could have some income,
7 and discussing that was okay, as long as the deal stood
8 on its own two feet."

9 And then over at the top of the next page, Mr.
10 Hoffman is asked:

11 "QUESTION: You said the deal would have to
12 'stand on its own two feet.'

13 "ANSWER: Uh-huh.

14 "QUESTION: Can you explain what you meant by
15 that?

16 "ANSWER: It had to be a separately valued deal
17 that we would do with or without the settlement."

18 Do you call that, Professor, direct evidence
19 that Schering paid for delay?

20 A. No, I don't.

21 Q. Let's take a look at the testimony of Mr.
22 Driscoll.

23 A. Could I ask again whether I have that in one of
24 these binders?

25 Q. Yes, you do. It's at binder 2, tab 3.

1 A. Thank you.

2 Q. It is SPX 2004.

3 There is a question, "Was anything else
4 discussed at the meeting?" That's at page 65, line 18.

5 "ANSWER: --"

6 I'm sorry, Your Honor, I forgot to mention, Mr.
7 Driscoll was the official at Schering in charge of the
8 K-Dur brand at that time.

9 JUDGE CHAPPELL: Thank you.

10 BY MR. NIELDS:

11 Q. "ANSWER: I don't recall at that specific
12 meeting talking about from our standpoint a date when
13 we might -- when they might come onto the market from
14 our standpoint. I don't recall that at that meeting."

15 Excuse me, Your Honor, I'm reading from the
16 wrong part. Let me begin again. At line 18:

17 "QUESTION: Was anything else discussed at the
18 meeting?

19 "ANSWER: No. As I stated earlier -- well, we
20 did agree that we would go back and think about it and
21 that if possible or if we both agreed after the meeting
22 we'll get together again within the next four weeks.

23 "I mean, we had a discussion rather extensively
24 about his point about paying -- us paying them to end
25 the litigation, and he was pretty forceful in that,

1 very forceful as a matter of fact, and I was very
2 forceful in saying, We simply cannot do that."

3 Do you regard that as direct evidence of
4 payment for delay?

5 A. No, I don't.

6 Q. And then further down there's a question, "Did
7 you indicate that Schering was not prepared to pay \$60
8 or \$70 million?

9 "ANSWER: I indicated very forcefully that
10 Schering was not going to pay any sum to Upsher-Smith
11 simply for them to stay off the market."

12 Do you regard that as direct evidence of
13 payment for delay?

14 A. No, I don't.

15 Q. Now we're going to take a look at Mr. Kapur's
16 testimony. This is also in binder 2 -- have you found
17 the tab?

18 A. I have found it, thank you.

19 Q. Okay, and it is SPX 2007. This testimony was
20 given July 21st, 2000.

21 Mr. Kapur is the Schering official, Your Honor,
22 who is in charge of generics.

23 "QUESTION: Did Mr. Driscoll say why he would
24 not pay Mr. Troup?

25 "ANSWER: He said as -- my recollection is he

1 told him that his legal people --" and there's an
2 interruption, and he continues with his answer.

3 "That his legal people would not allow him to
4 do that. They saw it as being problematic and it was
5 just not -- therefore, he really couldn't do anything.
6 That his legal people wouldn't allow him and they
7 wouldn't allow him to do that."

8 Do you regard that as direct evidence of
9 payment for delay?

10 A. No, I don't.

11 Q. Now, did any of these witnesses ever contradict
12 the testimony that I've just read?

13 A. Not directly.

14 Q. In what fashion did they if not directly, sir?

15 A. In the -- they -- I'm thinking, for example, of
16 Mr. Hoffman, whom I quoted the other day, saying that
17 it turned out that it was the licenses.

18 Q. That it turned out there was a license?

19 A. That it was the licenses, I'm sorry.

20 Can you not hear me?

21 Q. I couldn't hear the last thing you said.

22 A. Oh, okay.

23 Q. I'm sorry, you say Mr. Hoffman's testimony, it
24 turned out that it was the licenses, is direct evidence
25 of payment for delay?

1 A. Yes. The -- that links the discussion --
2 discussion of the payment to settle the lawsuit to the
3 payment that ultimately was made which was in the form
4 of that license agreement.

5 Q. Are you saying, sir, that there is some direct
6 testimony that Schering paid the money for the license
7 as a way of delay?

8 A. No, I'm saying -- you asked me earlier whether
9 anyone had contradicted this, and I said no, not
10 directly, but I believe the quote I made from Mr.
11 Hoffman, which I only paraphrased this morning but
12 quoted literally the other day, does link them.

13 Q. Well, let me put the question to you this way:
14 You've got the transcripts in front of you. Can you
15 identify the testimony that you say constitutes direct
16 evidence of payment for delay?

17 A. Yes. The -- the -- if I may refer to a part of
18 my report you pointed to earlier when we began this,
19 they're quoted there.

20 Q. I believe you'll find your report at binder 1,
21 tab 1.

22 JUDGE CHAPPELL: Professor, could you move the
23 microphone closer so we could hear you? Thank you.

24 THE WITNESS: Thank you.

25 Mr. Nields, could you do the same on that end?

1 Considerable difficulty hearing you as well.

2 Mr. Nields, the quotes to which I'm referring
3 to -- begin on page 29 of my report. They begin with
4 some quotes from Mr. Driscoll. Would you like me to
5 return to Mr. Driscoll's transcript or -- I'm not sure
6 what you want me to do at this point.

7 BY MR. NIELDS:

8 Q. You can use either the transcript or the report
9 if the report is a quote.

10 A. The -- they're quoted in the footnotes. The
11 first one is in footnote 51, which in -- I in my report
12 summarize as, "He," Mr. Driscoll, "recalled Mr. Troup
13 argued that Schering was merely trying to keep Upsher
14 off the market, and that he wanted to enter within a
15 year," and then there's the quote in -- the two quotes
16 in footnote 51 from Mr. Driscoll at two pages -- well,
17 I thought of it as a deposition, but it -- the IH is
18 investigational hearing, on pages 64 and 65.

19 Would you like me to read them or --

20 Q. I sure would. If you think that they provide
21 direct evidence of payment for delay, you better read
22 them.

23 A. Driscoll, quoting Troup, "that all we're doing
24 is trying to prevent them from coming on the market."
25 Later, "Did Mr. Troup say anything about when he wanted

1 to come to market under a settlement? I don't recall a
2 specific date, but I do recall that he wanted his
3 product on the market within the next year."

4 So, this is direct evidence that there was
5 discussion in these negotiations of early or late entry
6 by the generic firm and discussion of the --
7 particularly from Mr. Troup that -- saying that the
8 other side, Schering, was trying to prevent them from
9 coming on the market. I view that as direct evidence
10 about the content of these negotiations.

11 Q. You mean, you're saying because they discussed
12 the subject of a payment, that that's direct evidence
13 that Schering paid?

14 A. Yes, the -- they discussed the subject and the
15 associated incentives. The Schering folks, indeed, did
16 say we can't pay you. This was a -- this was a
17 practical business problem which was solved with the
18 licenses.

19 Q. Professor, when people talk about a subject,
20 doesn't it matter what they say on that subject?

21 A. Of course.

22 Q. And didn't Schering say, as we've already
23 learned, we will not do that?

24 A. Yes.

25 Q. All right. Did you point to any other direct

1 evidence that Schering agreed to pay for delay?

2 A. The -- there are several other quotes here that
3 I make. Again, they will be, let me say, of the same
4 form; that is to say, just picking up on what you just
5 said, they will be of the form that there was
6 discussion of payment for delay in the -- that -- and
7 so I am going to continue to agree with you on that.

8 Q. Just let me make sure I understand. I don't
9 want to waste time.

10 A. Right.

11 Q. Are you saying that other places in your
12 report, you note that the parties discussed the subject
13 of payment for delay and that Schering said Schering
14 would not do that?

15 A. Yes, they discussed the subject, the amount,
16 they discussed both of their incentives. I mean,
17 that's what these -- that's what's in these footnotes.

18 Q. And you regard that as direct evidence of
19 payment for delay?

20 A. Yes.

21 Q. Okay. You have mentioned the subject of
22 incentives, Professor, here today, and you mentioned
23 them in your direct, and you mentioned them in your
24 report. Is that correct?

25 A. Yes, that's correct.

1 Q. Before I go to that, also in your direct
2 testimony, you mentioned a particular document entitled
3 Executive Summary. Do you remember that one?

4 A. I do.

5 Q. You testified about it extensively in your
6 direct, did you not?

7 A. I think that's right, yes.

8 Q. I'm going to put it on the ELMO, and I'm going
9 to ask you about a part of it that you didn't mention
10 in your direct testimony. At line 3 or number Arabic
11 3, if you read the introductory clause in 3, it says,
12 "Section discussions with Upsher-Smith must achieve the
13 following goals. 3, Any agreement passes all legal and
14 regulatory constraints (e.g. FTC)."

15 Do you see that?

16 A. Yes -- I mean, I'm sorry, do we have it in a
17 binder? I think I have it in this binder.

18 Q. I don't believe it's in any of the three
19 binders --

20 A. It's -- it's in the one I have held over. Do
21 you recall its CX number, sir?

22 Q. It's got CX 283. I have a copy I can hand you.
23 Can I approach the witness, Your Honor?

24 JUDGE CHAPPELL: Yes.

25 THE WITNESS: Thank you. And I just found it

1 as well.

2 BY MR. NIELDS:

3 Q. Do you have that in front of you?

4 A. I do, and I am looking at paragraph or bullet 3
5 here.

6 Q. Do you have any reason to believe, Professor,
7 that that was anything other than a sincere requirement
8 in the mind of whoever wrote this document at the time?

9 A. No.

10 Q. Now I'd like to go back to your report on the
11 subject of incentives. In your report you state, in a
12 separately headed section entitled Incentives, as part
13 of your position that there was payment for delay, you
14 state, "Simply examining the incentives of the parties
15 leads to the conclusion that at least some of the \$60
16 million was payment for delay. Schering has a powerful
17 incentive to pay for delay."

18 Do you see that?

19 A. I do.

20 Q. And you wrote that?

21 A. I did.

22 Q. Professor, is it your view that if a person has
23 an economic incentive to violate the law, that that
24 leads to the conclusion that they did so?

25 A. No.

1 Q. Doesn't the proposition you state that's up on
2 the board ignore the fact that most of the people most
3 of the time in this country want to obey the law
4 because it's the right thing to do?

5 A. No, it doesn't.

6 Q. Well, does this principle of human behavior
7 apply to you?

8 A. I'm sorry, which principle of human behavior?

9 Q. That an economic incentive to do something
10 leads to the conclusion that a person did it.

11 A. The -- I mean, that's not all that's here.
12 The -- here, there is not only the incentives but a
13 contract in which there is a payment to the entrant.

14 Q. Well, that's the issue we're trying to answer,
15 Professor. Doesn't the statement you have made that I
16 wrote up on the board say "simply examining the
17 incentives of the parties"?

18 A. Yes, in light of what they did. I mean, not --
19 it doesn't say that everyone will break the law every
20 time they have an economic incentive to do so.

21 Q. Well, in fact, most of the time people won't.
22 Isn't that true?

23 A. I think that's right.

24 Q. And you wouldn't, would you?

25 A. That's right.

1 Q. Even in your economic behavior.

2 A. That's right.

3 Q. You would not sell your opinion to the highest
4 bidder even if you could make more money doing that.

5 A. Absolutely not.

6 Q. And that would be true of your colleagues at
7 Stanford.

8 A. That's right.

9 Q. And it would be true of people in the
10 Department of Justice that you used to work with.

11 A. I think so.

12 Q. And it would be true of most of the people you
13 know.

14 A. Yes.

15 Q. And indeed, most people most of the time do the
16 right thing simply because it's the right thing to do,
17 don't they?

18 A. I think that's right.

19 Q. And that would include lawyers at large
20 companies.

21 A. Yes.

22 Q. And it would include businessmen of large
23 companies.

24 A. Yes, most of the time in most of their things,
25 I would expect both of those categories of people to do

1 the right thing.

2 Q. Professor, I'm going to move on then past
3 incentives to the next reason that you gave in your
4 testimony for why you have concluded that Schering paid
5 for delay. You said you based your opinion on
6 something called the revealed preference test. Do you
7 recall that?

8 A. I do.

9 Q. And that's another way of saying, isn't it,
10 that you concluded that Schering couldn't have believed
11 Niacor was worth \$60 million because they didn't pay
12 for Niaspan.

13 A. Well, not exactly. The "because" part is
14 broadly right.

15 Q. Because they didn't pay for Kos' Niaspan
16 product, you have concluded that they couldn't
17 sincerely have believed Niacor was worth \$60 million.

18 A. I don't know about "sincerely have believed."
19 That's sort of not my -- my territory. The -- I
20 believe they have revealed their willingness to pay for
21 an opportunity of this kind.

22 Q. As a result of what they did in their
23 negotiations for Kos' Niaspan?

24 A. Yes, that's right.

25 Q. I've got it right. That's --

1 A. That part, yes.

2 Q. I'm in the right ballpark at least.

3 A. Oh, absolutely.

4 Q. Okay. Now, doesn't the inference that one
5 should draw from the outcome of Schering's negotiations
6 with Kos depend a lot on the particular circumstances
7 of that deal?

8 A. I think it depends. I don't know what you
9 mean, "a lot." I mean, it depends on that deal.

10 Q. Well, let's talk about the two deals, if we
11 can, see if we can get on the same page.

12 The Niacor-SR transaction involved Schering
13 acquiring the rights to market -- the exclusive rights
14 to market Niacor-SR outside the United States, Canada
15 and Mexico. Is that correct?

16 A. That's correct.

17 Q. And they paid for the right to market Niacor-SR
18 outside of the United States, Canada and Mexico.

19 A. Yes, I think they paid something for that
20 right.

21 Q. It was a license.

22 A. Yeah, the -- it was a license.

23 Q. And as a result of that, they acquired the
24 rights to keep all of the profits from those sales,
25 less royalty payments and milestones.

1 A. Right, that was the form of the -- that was the
2 form of the payment agreement, taking out the
3 noncontingent part, yes.

4 Q. And they had total control over the marketing
5 of Niacor-SR in the geographical areas covered.

6 A. Yes, that's -- well, total control, I mean,
7 not -- they weren't working under the control of
8 Upsher.

9 Q. Of Upsher-Smith.

10 A. Right.

11 Q. I mean, they in effect -- it was their product
12 to market as they pleased in -- outside of the United
13 States, Canada and Mexico.

14 A. I don't -- I don't know about the meaning of
15 "their product," but I think I know what you mean. I
16 mean, they got -- they had the right to market this
17 product, keep the money and pay -- pay fees under a
18 schedule.

19 Q. Now, the Niaspan deal that was under discussion
20 with Kos was somewhat different, wasn't it?

21 A. Yes.

22 Q. It is what is known in the pharmaceutical
23 industry as a co-promote. Isn't that right?

24 A. I believe that's right.

25 Q. Are you familiar with the term "co-promote" as

1 it's used in the pharmaceutical industry?

2 A. Yes.

3 Q. And a co-promote is in the nature of a joint
4 venture, is it not?

5 A. I think typically you would label a co-promote
6 as a joint venture, yes. I'm hesitating because the
7 word "joint venture" is a word that covers a lot of
8 turf -- or not the word, the phrase.

9 Q. And in this co-promote/joint venture
10 arrangement that was under discussion, Kos was in
11 effect -- Kos was in effect contributing the product
12 and some sales force behind it, and Schering was
13 contributing sales and marketing. Is that your
14 understanding?

15 A. That's my understanding.

16 Q. Do you happen to recall whether the value or
17 the cost to Schering of the sales and marketing that
18 they were offering to put behind Kos' product was
19 valued at about \$30 million for the first two years?

20 A. No, I don't recall that.

21 Q. Okay. And under this co-promote or joint
22 venture, the parties were planning to share the profits
23 in some way. Is that correct?

24 A. Yes, there was -- there were contractual
25 terms -- well, under discussion. I don't believe that

1 they reached an agreement. They were contemplating a
2 contract that would share the profits between them.

3 Q. And necessarily they would have to share
4 control over how the product was marketed. Isn't that
5 also true?

6 A. I guess that's true. That must be -- that must
7 be -- again, I -- you know, I'm -- I don't want to say
8 more than I know about control over how the product was
9 marketed, but they were both going to be doing it.

10 Q. Well, are you aware that that was the subject
11 of some discussion between the parties --

12 A. Yes.

13 Q. -- as to who would have control, strategic
14 control?

15 A. Yes.

16 Q. And Kos wanted to have most of it themselves.
17 Isn't that right?

18 A. I think that's right.

19 Q. Now, before the negotiations had terminated, is
20 it true that Schering had indicated it wanted half of
21 the profits, after expenses, and Kos didn't agree to
22 that? Is that your understanding?

23 A. I think that's right.

24 Q. Now, you said on your direct testimony that
25 when you apply this revealed preference test, you rely

1 on what you called the chooser's judgment as to what
2 something was worth. Do you recall that?

3 A. I do.

4 Q. And the chooser in this example would be
5 Schering. Is that correct?

6 A. Yes.

7 Q. Did you look at how Schering valued Niaspan at
8 the time of these negotiations?

9 A. I -- there was a -- there was a spreadsheet
10 that was part of the decision process that I recall
11 reading.

12 Q. And do you know whether it was prepared by the
13 principal negotiator for Schering?

14 A. No, I don't recall who prepared it exactly.

15 Q. Do you know who Ray Russo is?

16 A. Yes.

17 Q. At your deposition, you didn't know who he was.
18 Is that right?

19 A. That's right.

20 Q. Even though you had already reached your
21 opinion.

22 A. Yes.

23 Q. But you know that he is the principal
24 negotiator for Schering.

25 A. I do.

1 Q. I'm putting up on the screen, Professor, a
2 spreadsheet. Is that -- to your knowledge, does that
3 reflect Mr. Russo's or at least somebody at Schering's,
4 if you don't know it's Mr. Russo, projections for what
5 the sales of the Kos product were going to be in the
6 U.S.?

7 A. While I don't recall the specific numbers, it
8 doesn't look -- it reminds me of the spreadsheet I
9 read.

10 Q. Do you have any reason at all to doubt that
11 those numbers reflect Mr. Russo's best business
12 judgment at the time?

13 A. No.

14 Q. That means, no, you have no reason to doubt it?

15 A. Yes, I'm sorry, yes. I had this problem the
16 last couple of days. There's no "danke" in English
17 like the good German word which means, you know, yes
18 but no. How should I answer? What's the --

19 Q. I'll reframe the question in the affirmative.

20 A. Okay.

21 Q. To the best of your knowledge, this spreadsheet
22 represents Ray Russo's best business judgment at the
23 time as to the sales that Kos' product was likely to
24 bring.

25 A. Yes, that's right.

1 Q. And do you know whether Ray Russo's boss, Marty
2 Driscoll, translated these sales numbers into a net
3 present value of the profit stream from these sales?

4 A. I know what someone did, but I don't know that
5 it was Mr. Driscoll.

6 Q. Do you remember what the number was?

7 A. No.

8 Q. I am going to put on the ELMO a document which
9 is a memorandum written by Marty Driscoll to his boss,
10 Richard Zahn, on June 9th, 1997. Yes, you do, but it's
11 going to take me a moment to tell you where. It's in
12 your -- it's in the complaint counsel's binder at
13 Exhibit CX 558.

14 A. Thank you.

15 Q. And I believe you even recited from memory the
16 number on this document during your deposition. Do you
17 recall doing that?

18 A. No, I'm sorry, I don't.

19 Q. Well, look at the first page of it. Mr.
20 Driscoll writes, "Under the assumption that we could
21 negotiate terms as favorable as a 50/50 split on gross
22 profits, our revenue would only equal \$67 million in
23 the peak year and the 10 year NPV is projected at \$127
24 million."

25 Do you see that?

1 A. I do.

2 Q. And if a 50/50 split gets Schering a net
3 present value of \$127 million, how much would that mean
4 that the product would bring for both parties?

5 A. Presumably twice that or \$254 million, if they
6 discounted -- if they discounted the same way.

7 MR. NIELDS: Your Honor, may I approach and put
8 up a chart?

9 JUDGE CHAPPELL: Yes.

10 BY MR. NIELDS:

11 Q. Is that chart familiar to you, Professor?

12 A. Yes.

13 Q. Is that a chart comparing Niaspan and Niacor
14 that you've testified about in your direct?

15 A. It is.

16 Q. And it's got an additional line at the bottom.
17 Do you see that?

18 A. I do.

19 Q. It says, "Net Present Value."

20 A. Yes.

21 Q. I'm going to write in the net present value
22 coming from U.S. sales of Niaspan that you just
23 testified to. Do you see that?

24 A. I do.

25 Q. Excuse me, I need an M here. Okay?

1 A. Yes.

2 Q. Now, yesterday you testified about the net
3 present value that Schering's people placed on Niacor
4 sales overseas at the time based on their evaluation of
5 Niacor. Do you remember that?

6 A. Yes.

7 Q. And that was \$225 million to \$265 million. Is
8 that correct?

9 A. I don't recall the number. But I'm sure you're
10 right.

11 Q. Let's just make sure we don't just take my word
12 for it. I've got here CX 341, which is the packet of
13 information provided by Schering to its board of
14 directors analyzing the Niacor license opportunity, the
15 last page of which contains a number for economic
16 value.

17 A. Yes, I see that.

18 Q. Which you testified about yesterday.

19 A. That's right.

20 Q. Do you see that? And you said that was
21 essentially the same as net present value, and I'm
22 going to write those numbers up under the Niacor line.
23 Do you see that?

24 A. I do.

25 Q. Now, on the right-hand side under Niacor,

1 that's the amount Schering projected that it would get
2 after taking account of its up-front payment, its
3 milestones and its royalties, correct?

4 A. Yes, I think that's right.

5 Q. And on the right-hand side, I've written \$254
6 million, but that's the amount that would be available
7 to both parties, and Schering wasn't even sure it could
8 get half. So, I'm going to just assume maybe they
9 could get half in their negotiations.

10 Now, I've written in \$127 million under the
11 Niaspan line. Do you see that?

12 A. Yes.

13 Q. Now, Professor, isn't it possible that one of
14 the preferences that might have been revealed by
15 Schering's terminating its discussions with Kos is that
16 they preferred all of the profits from a product to
17 half the profits?

18 A. I'm -- I'm sure -- I don't think that needs to
19 be revealed, that they would prefer half of the profits
20 to all of the profits. I mean, they also directly in
21 the course of doing that discussed the comparison
22 between the United States and the rest of the world.

23 Q. Yeah, you said that you were sure they would
24 prefer half. That was a little bit of a slip, wasn't
25 it? You mean they would prefer all to half.

1 A. I'm sorry if I -- yes. You don't need -- you
2 don't need revelation to learn that they would prefer
3 all to half. If I said half to all, I misspoke.

4 Q. You misspoke.

5 Now, you just raised the subject of comparing
6 the size of the markets. Do you happen to recall from
7 your review of documents in this case, Professor, what
8 the relative size of the cholesterol-reducing drug
9 market was in the United States as compared with
10 outside?

11 A. The -- the overall cholesterol market?

12 Q. Yes.

13 A. I recall some -- some discussion of that with I
14 think the rest of the world being larger than the
15 United States as to the overall cholesterol market.

16 Q. Now, yesterday or maybe it was the day before,
17 you were asked a question about licensed area, and I
18 take it that means the licensed area for Niaspan was
19 U.S., and the licensed area for Niacor was everywhere
20 outside the U.S. except Canada and Mexico. Is that
21 right?

22 A. That's right.

23 Q. And you put a plus next to the United States.

24 A. Yes.

25 Q. And a minus next to outside the United States,

1 Canada and Mexico.

2 A. That's correct.

3 Q. And you just told us that the documents you saw
4 showed that the cholesterol market outside the U.S. was
5 bigger than the cholesterol market in the U.S.?

6 A. That's right, but there was also a direct
7 discussion of this product, by which I mean Niaspan,
8 inside and outside the United States, which is closer
9 to the issue at hand than the overall cholesterol
10 market, which it's my understanding -- I don't know if
11 it's a market. I mean, it -- you know, "market" means
12 denominator to a marketing guy. The overall, you know,
13 marketplace for cholesterol-reducing drugs, which is --
14 has mostly other kinds of drugs in it.

15 Q. Well, what pricing assumptions went into Mr.
16 Russo's projections for Niaspan in the U.S.?

17 A. I don't know his specific pricing assumptions.

18 Q. Do you know whether it was at the price of
19 generic gemfibrozil?

20 A. I don't.

21 Q. You don't know what pricing assumption he used.

22 A. I don't.

23 Q. And what assumption was made by Mr. Audibert
24 for Niacor overseas?

25 A. Similarly, I didn't look at his pricing

1 assumptions.

2 Q. You what?

3 A. I'm sorry, I didn't look at his pricing
4 assumptions.

5 Q. But I thought you based your plus opposite
6 licensed area for Niaspan and your minus opposite
7 Niacor on the theory that it was harder to get a good
8 price in Europe.

9 A. That's the -- that's the underlying theory.
10 It's also what the Schering folks, not specifically
11 about the licensing, the Schering folks also wrote that
12 he, Mr. Bell from Kos -- though I don't recall the full
13 quote -- something like, you know, "agrees with us
14 there's less of an opportunity outside the United
15 States than here."

16 Q. Would it surprise you to learn that Schering's
17 expert on pricing in Europe said that Mr. Audibert was
18 correct in his assumptions because he could sell Niacor
19 in Europe at the price of generic gemfibrozil?

20 A. No.

21 Q. Now, in your study of the negotiations between
22 Schering and Kos, did you come to learn some of the
23 reasons why Schering terminated its negotiations with
24 Kos?

25 A. Yes.

1 Q. And is it fair to say that one of the reasons
2 was that Kos had exaggerated ideas about how much
3 Niaspan was worth?

4 A. I don't know about the word "exaggerated," but
5 the idea, I think yes.

6 Q. Kos thought it was worth more, that it would
7 bring significantly more sales than Schering did.

8 A. I think that's right.

9 Q. And that that would translate into Kos
10 demanding a higher share of the profits.

11 A. Or a significant up-front payment.

12 Q. And did you learn that another reason was that
13 Kos' negotiators had been, for want of a better term,
14 rude during the negotiations?

15 A. I heard discussion of that as well.

16 Q. And would that matter if you were doing a joint
17 venture in the nature of a partnership?

18 A. In some kinds of partnership, that would
19 matter, yes.

20 Q. Well, I wasn't asking you your opinion. I was
21 asking you whether you learned that that mattered to
22 Schering.

23 A. Yes.

24 Q. And that they were very concerned about the
25 issue of control, particularly control over Schering's

1 detailing?

2 A. The detailing priority issue, yes, they were --
3 I don't know about "very concerned," but it was
4 definitely an issue.

5 Q. Now, did you learn that there was an issue
6 about who was going to actually be able to book the
7 sales of Niaspan, in other words, which company would
8 show the sales on their books and records?

9 A. I recall that Schering wanted to be able to
10 book sales connected to something like we don't want to
11 just be a "rent a sales force."

12 Q. And that Kos said if they wanted to book sales,
13 they would have to pay Kos the money to do it?

14 A. I don't recall that in specific. I know that
15 Kos was definitely demanding money.

16 Q. Now, did you learn that another reason was that
17 Kos would not share its clinical information regarding
18 the intensity of the flushing that Niaspan caused?

19 A. I don't recall the specifics about the
20 intensity of the flushing. I do recall that there --
21 that the Schering people wanted the Kos people to share
22 more clinical trials kind of information.

23 Q. I'm putting in front of you Mr. Driscoll's memo
24 again.

25 A. Yes.

1 Q. And do you see where he says -- by the way,
2 this is his memo in which he's recommending terminating
3 the discussions with Kos. Is that right?

4 A. That's my understanding, yes.

5 Q. And he says, "Kos maintains that 'the intensity
6 of flushing' with Niaspan is much less than seen with
7 the immediate-release niacin products."

8 Then the next line down he says, "Kos has been
9 unwilling to share the clinical data that would
10 substantiate these claims."

11 A. Right, although I recall him somewhere saying
12 that he had gotten a flushing figure -- there's an
13 awful turn of phrase -- a number about the amount of
14 flushing from another source.

15 Q. Well, it's in this memo. Maybe this will
16 refresh your memory. Eighty-eight percent of the
17 people who took Niaspan experienced some flushing. Kos
18 had told them that the intensity of the flushing had
19 been significantly reduced. Isn't that right? And
20 they wouldn't give Schering the clinical data that
21 would support that.

22 A. That's right.

23 Q. All right, I'm finished with the revealed
24 preference test, Professor. I think you had another
25 arrow in your quiver, so to speak, on the -- that

1 supports your opinion as to that Schering, in fact,
2 paid Upsher for delay. I think you called that the
3 principle of the market test. Do you recall that?

4 A. I do.

5 Q. And that refers to Upsher's efforts to find
6 a -- someone that would -- with which they could
7 conclude a license for Niacor overseas.

8 A. Yes.

9 Q. And I think you testified yesterday that you've
10 never actually reviewed any other similar effort by any
11 other pharmaceutical company.

12 A. No, not in a pharmaceutical company.

13 Q. Do you know how Schering normally evaluates an
14 in-licensing opportunity?

15 A. No, other than what I've read here, no, I do
16 not.

17 Q. So, for example, you don't know if they -- when
18 they're negotiating to acquire the rights to someone
19 else's product, you don't know whether they are
20 generally aware of other bids?

21 A. No, I don't know whether they make inquiries
22 about other bids or pay attention to the other bids.

23 Q. You don't know if they even care, do you?

24 A. No.

25 Q. Would it surprise you, Professor, to learn that

1 in the vast majority of cases, Schering has no idea
2 whether there are other bidders much less whether they
3 bid anything?

4 A. No. There are bid markets that are like that,
5 so it wouldn't surprise me.

6 Q. Would it surprise you if Schering, when they
7 have negotiations to acquire the rights to somebody
8 else's product, would it surprise you if frequently
9 they're confident there aren't any other bidders?

10 A. No, that wouldn't surprise me either. They
11 might know that sometimes.

12 Q. Would it surprise you that what Schering -- to
13 learn that what Schering does as a regular practice is
14 to do its own evaluation of the product they're
15 thinking of licensing and make their own sales
16 projections?

17 A. I'm -- I would be surprised if as part of its
18 decision to bid, Schering didn't always perform its own
19 evaluation, and that would include a sales projection.

20 Q. Do you recall -- you've read Dr. Levy's report,
21 haven't you?

22 A. Yes.

23 Q. Do you remember noticing that in the back of
24 it, he described a licensing transaction Schering did
25 with a company called ICN?

1 A. I recall that there's a -- that there are a
2 number of those back there and in a table, I think, but
3 I don't recall ICN in particular.

4 Q. Would it surprise you to learn that that
5 transaction involved in-licensing the rights to someone
6 else's drug --

7 A. ICN's?

8 Q. I haven't finished the question.

9 A. Oh, sorry.

10 Q. -- in which Schering knew that there were no
11 other people negotiating with ICN?

12 A. No.

13 Q. That it was a new chemical?

14 A. New chemical entity?

15 Q. Yeah. Not like Niaspan, but I mean a new
16 chemical entity, that had been twice rejected by the
17 FDA, and that they offered \$30 million up front?

18 A. The --

19 Q. Would it surprise you to learn that?

20 A. No, or not. I haven't -- I haven't looked at
21 that particular one, so I have no knowledge of it.

22 Q. So, if I were to ask you the questions like Mr.
23 Kades did yesterday, did another company bid \$30
24 million for ICN, did another company bid \$20 million
25 for ICN, did another company bid \$10 million for ICN,

1 you wouldn't know what the answer would be?

2 A. No, I got lost at the start of that. I thought
3 it was Mr. Gidley yesterday.

4 Q. Well, I had the wrong day but the right person.

5 A. So, Mr. Kades' question of the other day.

6 Q. Yes.

7 A. I got derailed, I'm sorry. The -- I don't
8 recall what you asked after that, because I was trying
9 to figure out what you were saying.

10 Q. Well, I'll tell you what, why don't we just
11 move along.

12 A. I -- I suspect the answer was -- I would have
13 given the same answer, but I'm not sure.

14 Q. I want to pursue your notion of a market test
15 just for a minute further. Do you -- do you know what
16 the market capitalization of Kos was around the time
17 that Schering struck the deal with Upsher for Niacor?

18 A. I've seen it, but I don't recall the number.

19 Q. Do you recall if it was in the range of half a
20 billion dollars?

21 A. No. I wouldn't be surprised to learn that,
22 though.

23 Q. Well, if -- if I asked you to -- let me ask you
24 to assume some things and then ask you what flows from
25 them.

1 Assume that Kos was for all intents and
2 purposes a one product company at that time.

3 A. Okay.

4 Q. Niaspan being the product.

5 A. Meaning without a -- without a prospect of more
6 products or --

7 Q. Some prospect but not -- not enough to affect
8 the market interest in their stock.

9 A. Okay, so that other products are adequately
10 distant or uncertain or something. Okay, I'm with you.

11 Q. Correct, that's the thing I would want you to
12 assume.

13 A. Okay.

14 Q. Assume that the market capitalization of Kos is
15 about \$500 million.

16 A. Okay.

17 Q. Would that mean that the market valued Niaspan
18 at somewhere in the range of \$500 million?

19 A. Yes, if the -- if the -- if they were a one
20 product company for sure, and that was the only -- that
21 was their only prospect, then I would -- and, you know,
22 Niaspan on a worldwide basis, under those assumptions,
23 the stock market is valuing that prospect at that
24 level.

25 MR. NIELDS: I'm happy to continue, Your Honor,

1 but I am at a pretty clean dividing line between the
2 topic I've just covered and the topics that are to
3 come.

4 JUDGE CHAPPELL: Why don't we try to break
5 around 1:00, Mr. Nields.

6 MR. NIELDS: Sure.

7 BY MR. NIELDS:

8 Q. Professor, I've put a quote from I believe it's
9 page 13 of your report in this case up on the screen,
10 and it reads, "If an entrant would only find it
11 worthwhile to settle if paid something, then we can be
12 certain that the settlement contract delivers less
13 competition than would litigating."

14 Do you see that?

15 A. Yes.

16 Q. And is that an opinion that is contained in
17 your report?

18 A. Yes, I think it is.

19 Q. And do you think it's still right?

20 A. Yes.

21 Q. Now, is it true, Professor, that other
22 reputable economists disagree with that statement?

23 A. I don't know if they disagree with this
24 statement.

25 Q. Well, then I am going to ask you then to look

1 at page 183 of your deposition transcript. Is it true
2 that I asked you the following question and you gave
3 the following answer:

4 "QUESTION: In your report on page 13, you say,
5 'If an entrant would only find it worthwhile to settle
6 if paid something, then we can be certain that the
7 settlement contract delivers less competition than
8 would litigating.'

9 "ANSWER: Yes, I see that.

10 "QUESTION: Do you see that?

11 "Are you aware that there are other economists
12 that don't agree with that opinion of yours?

13 "ANSWER: I am aware that there are other
14 economists working as experts in this matter who
15 disagree generally. I'm not sure whether they disagree
16 specifically with -- with this part.

17 No, I'm sorry, that's incorrect. They -- I am
18 aware that they also disagree specifically with this
19 part."

20 Do you recall giving that testimony?

21 A. Yes, I do.

22 Q. Was that accurate?

23 A. That was, and there, as here, I began by
24 forgetting it, and there I remembered it, but here I
25 didn't. Thank you for refreshing my memory.

1 Q. And those economists include Professor Willig.
2 Is that right?

3 A. Yes, that's right.

4 Q. And is he the former chief economist at the
5 FTC?

6 A. No.

7 Q. DOJ?

8 A. Yes.

9 Q. Sorry, wrong agency.
10 Carl Shapiro?

11 A. I don't know whether Carl is one of the people
12 that disagrees specifically with that.

13 Q. I am going to show you your deposition
14 transcript again. I haven't highlighted this,
15 Professor.

16 A. No, but I see that I did say that it would also
17 include Carl, so certainly I did include Carl Shapiro.

18 Q. So, those are three, and is Carl Shapiro also a
19 chief economist at the Antitrust Division, United
20 States Department of Justice?

21 A. Yes.

22 Q. Now I'm going to put in front of you a
23 quotation from an article by a person named Richard
24 Gilbert. Do you know Mr. Gilbert?

25 A. I do, Professor Gilbert from Berkeley. I also

1 know Willard Tom, although his name is misspelled here.
2 Unfortunately this one makes me seasick. Do you have
3 this one in exhibit form?

4 Q. Yes, this one you will find in the notebook in
5 front of you at binder 2, tab 8.

6 A. Thank you.

7 Q. You will find the quoted language at page 78.

8 Just for the record, Your Honor, this does have
9 an SPX number, SPX 836.

10 JUDGE CHAPPELL: Thank you.

11 MR. NIELDS: Your Honor, apparently two of the
12 monitors have gone out. I don't know whether -- our
13 monitors are fine, the witness' monitor is fine. I'm
14 prepared to proceed, but Mr. Kades' monitor is gone,
15 and I don't want to prejudice him.

16 JUDGE CHAPPELL: Whose monitor is out?

17 THE REPORTER: Mine.

18 MR. KADES: Your Honor, my monitor is out.

19 MR. RAOFIELD: I have a hard copy of the exact
20 slide on the screen.

21 JUDGE CHAPPELL: It looks like unforeseen
22 events have forced us into a break before 1:00, Mr.
23 Nields, so why don't we take a recess, 45 minutes, and
24 if I'm reading the clock right, we'll go back on the
25 record, we will reconvene at 1:40, 1-4-0. We're in

1 recess.

2 MR. NIELDS: Thank you, Your Honor.

3 (A brief recess was taken.)

4 (Whereupon, at 12:55 p.m., a lunch recess was
5 taken.)

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1 AFTERNOON SESSION

2 (1:50 p.m.)

3 JUDGE CHAPPELL: Back on the record, docket
4 9297.

5 You may proceed.

6 BY MR. NIELDS:

7 Q. Professor, when we broke, we were talking about
8 some statements of Richard Gilbert, but I think we
9 forgot to fully introduce him. Is he a professor of
10 economics?

11 A. Yes.

12 Q. At U-Cal Berkeley?

13 A. Yes.

14 Q. And was he previous head economist at the
15 Department of Justice?

16 A. At the Antitrust Division, yes.

17 Q. Antitrust Division of the Department of
18 Justice?

19 A. Yes.

20 Q. And to your knowledge, did he work extensively
21 on the intellectual property guidelines --

22 A. I believe he did.

23 Q. -- published by the Antitrust Division of the
24 DOJ?

25 A. Yes.

1 Q. Now, the article that he wrote, which is in
2 front of you, I believe it's binder 2, tab 8, you had
3 indicated some of the other economists who disagreed
4 with you had been retained by parties in this case.
5 Mr. Gilbert has not been retained by any parties in
6 this case, to your knowledge, has he been?

7 A. No.

8 Q. And so what he wrote was in a scholarly
9 article, correct?

10 A. Yes.

11 Q. And that article is in part about cases that
12 the FTC has brought in the generic drug field, correct?

13 A. Yes, that's right.

14 Q. And indeed, he makes reference in his article
15 to this very case.

16 A. I think that's right.

17 Q. And he indicates that he's read the complaint
18 in this case and seen the allegations in the complaint.
19 Is that right?

20 A. I don't recall it, but it might be right.

21 Q. Well, let's just take a quick look here.

22 JUDGE CHAPPELL: While you're pausing, Mr.
23 Nields, we are going to attempt to leave the back door
24 open to see if we get a breeze. Let me know if it
25 interferes with your questioning, or Professor, let me

1 know if it interferes with your hearing the question.

2 THE WITNESS: Very well.

3 JUDGE CHAPPELL: Thank you.

4 MR. NIELDS: I cannot imagine a breeze
5 interfering with anything here, Your Honor.

6 BY MR. NIELDS:

7 Q. So, Mr. Gilbert is saying in this article,
8 describing the complaint, "According to the complaint,
9 Schering-Plough agreed to pay Upsher-Smith and ESI
10 Lederle \$60 million and up to \$30 million,
11 respectively. In part, these payments were ostensibly
12 for licensing certain products to Schering-Plough, but
13 the FTC alleged that the payments were unrelated to,
14 and greatly exceeded, the value of those products, if
15 any, to Schering-Plough."

16 So, he's describing the allegations in the
17 complaint, including the allegation that Schering paid
18 more for Niacor than it was worth, correct?

19 A. Yes, that's what he's saying. So, it's from
20 the complaint.

21 Q. And no indication that he's seen the defense or
22 knows anything about the defense, correct?

23 A. No.

24 Q. And then he goes on to say, "Based on the
25 allegations in the public record materials, these

1 agreements appear to be anticompetitive arrangements to
2 eliminate competition and to divide the monopoly
3 profits of the successful branded drugs." But then he
4 goes on to say, "However, these cases are not as simple
5 as they may appear."

6 Do you see that?

7 A. I do.

8 Q. And then if you go over to the next page, we
9 reach the part of the article, the quote that I had on
10 the board when we broke, and I am now going to switch
11 back to the Power Point and away from the ELMO.

12 Okay, now we have the statement by Mr. Gilbert
13 in his article, "What can be done to distinguish
14 potentially procompetitive settlements from those that
15 are likely to be anticompetitive?" Then he says, "The
16 fact that the settlement involves a payment from the
17 patentee to the challenger is not sufficient to
18 determine that the settlement is anticompetitive."

19 Do you see that?

20 A. I do.

21 Q. So, would you agree that Mr. Gilbert differs
22 with the opinion that was on the board before, your
23 opinion at page 13 of your report?

24 A. No, not with that one specifically, though
25 clearly he differs with me more generally.

1 Q. Okay. Well, let's just take a look at that one
2 specifically. You say, "If an entrant would only find
3 it worthwhile to settle if paid something, then we can
4 be certain that the settlement contract delivers less
5 competition than would litigating."

6 Do you see that?

7 A. That's right.

8 Q. And then he says, "The fact that the settlement
9 involves a payment from the patentee to the challenger
10 is not sufficient to determine that the settlement is
11 anticompetitive."

12 A. Right.

13 Q. Those two statements have different rings to
14 them, don't they?

15 A. No, as I said, Gilbert and Tom disagree with me
16 generally, but I don't think -- but there's -- but this
17 doesn't imply that they differ with the specific quote
18 from page 13.

19 Q. Well, in any event, I think you've already said
20 that there are several other reputable economists who
21 do differ with you.

22 A. That's true.

23 Q. And my question is this: Do economists,
24 particularly when they differ amongst each other, do
25 they ever test their opinions to see whether they work

1 in practice?

2 A. Sometimes.

3 Q. And isn't it true, sir, that there is a large
4 body of behavioral decision research showing that
5 individuals involved in negotiations often deviate from
6 the economic model of rationality?

7 A. I'm sorry, I missed the beginning of that one.

8 Q. All right, I'll read it to you again.

9 Isn't it true that there is a large body of
10 behavioral decision research showing that individuals
11 involved in negotiations often deviate from the
12 economic model of rationality?

13 A. What do you mean by "behavioral decision
14 research"? That's not a label that does anything for
15 me.

16 Q. Well, let me ask you this: Are you an expert
17 in negotiating?

18 A. No.

19 Q. And do you know if a professor named Max
20 Bazerman is?

21 A. I -- no, I don't know if he is.

22 Q. Well, isn't he the complaint counsel's expert
23 in negotiations that has filed a report in this case?

24 A. I think that's right.

25 Q. Now, I'm going to show you some testimony by

1 Mr. Bazerman under oath and ask you if you agree with
2 him.

3 "QUESTION: Is it true that there is a large
4 body of behavioral decision research showing that
5 individuals involved in negotiation often deviate from
6 the economic model of rationality?

7 "ANSWER: Yes."

8 Do you see that?

9 A. Well, I do, although I'd rather see it not on
10 the screen. Where is it?

11 Q. Okay, it's binder 1, tab 5.

12 A. Thanks.

13 Q. And it's page 47.

14 A. Great. Got it.

15 Q. Okay. Do you see that statement? Do you agree
16 with it?

17 A. I don't know whether to -- I mean, he obviously
18 knows what behavioral decision research means, which is
19 the clarifying question I had asked you earlier, and I
20 don't know what it means.

21 Q. Well, do you have any reason to differ with his
22 view that there is research showing that individuals
23 involved in negotiation often deviate from the economic
24 model of rationality?

25 A. No.

1 Q. And now let's keep going here. The next
2 question to Mr. Bazerman is:

3 "QUESTION: And is that true of experts as well
4 as naive negotiators?"

5 And he says, "Absolutely."

6 Do you have any reason to disagree with that?

7 A. No.

8 Q. Now, if, indeed, negotiators deviate from the
9 economic model of rationality, wouldn't it be important
10 in order to test an opinion about negotiated
11 settlements to have some practical testing to see
12 whether the economic theory works out in practice?

13 A. The -- I think the directions of departure from
14 economic rationality that are in the -- in the research
15 I know about are not ones that would lead me to do
16 further investigation when there's a large amount of
17 money at stake and done by firms that know the market.

18 Q. Well, let's keep going with Mr. Bazerman and
19 see if you agree or disagree with what he says. The
20 next question is:

21 "QUESTION: And do psychological factors enter
22 into it?

23 "ANSWER: Yes, that's a -- all these questions
24 refer to the core of my strongest expertise and the
25 part of the literature that I'm best known for."

1 Do you see that?

2 A. I do.

3 Q. Do you agree that psychological factors enter
4 into negotiations and settlements that people enter
5 into?

6 A. Yes, generally.

7 Q. Then he says, "And you show I take it and
8 believe and have written that psychological factors do
9 enter into negotiations and cause parties to reach
10 outcomes that are not consistent with rationality?"

11 He says, "That's right. And we specify the
12 specific directions that we predict -- we specify the
13 specific directions in which we expect human judgment
14 to deviate from rational models."

15 Do you see that?

16 A. Yes.

17 Q. Do you agree with that?

18 A. Yes.

19 Q. Now, generally, do you think it's a good idea
20 to test opinions and theories of economists in order to
21 see if they work in practice?

22 A. In general I think it's important to test
23 economic theories to see if they work in practice.

24 Q. I've now put up on the board something that was
25 written by a man named Milton Friedman. Do you know

1 who he is?

2 A. I do.

3 Q. Who is he?

4 A. Milton Friedman is a long-time professor of
5 economics at the University of Chicago, later the
6 Hoover Institution, who -- a distinguished
7 macroeconomist who won the Nobel Prize in economics.

8 Q. Now, he says the following:

9 "Viewed as a body of substantive hypotheses,
10 theory is to be judged by its predictive power for the
11 class of phenomena which it is intended to 'explain.'
12 Only factual evidence can show whether it is 'right'
13 or 'wrong' or, 'better,' tentatively 'accepted' as
14 valid or 'rejected.'" .

15 Then he says, "As I shall argue at greater
16 length below, the only relevant test of the validity of
17 a hypothesis is comparison of its predictions with
18 experience."

19 Do you see that?

20 A. Yes.

21 Q. Do you agree with that?

22 A. Yes.

23 Q. Now, let's go back to your opinion. "If an
24 entrant would only find it worthwhile to settle if paid
25 something, then we can be certain that the settlement

1 contract delivers less competition than would
2 litigating."

3 Do you see that?

4 A. I do.

5 Q. Now, you are comparing, are you not, the amount
6 of competition delivered by a settlement agreement with
7 the amount of competition delivered by litigating?

8 A. Yes.

9 Q. And you are saying if the settlement includes a
10 payment, it will always deliver less competition than
11 litigating.

12 A. Well, here, if the entrant were to only find it
13 worthwhile to settle.

14 Q. Okay. Now, how many settlement agreements have
15 you examined to see whether this actually proved true?

16 A. None. This is a -- this is a -- I'd have to
17 examine settlement agreements in which an entrant would
18 only find it worthwhile to settle if paid something to
19 test literally this statement. There are parts --
20 there are theoretical underpinnings of this statement
21 which I believe have been tested.

22 Q. So, you haven't tested this at all?

23 A. No, not literally in this form.

24 Q. Well, let's see if we can include not literally
25 in exactly that form. How many settlement agreements

1 involving payments to the potential entrant have you
2 examined to determine whether the settlement agreement
3 provided less or more or the same competition as
4 litigating?

5 A. No, I haven't examined the settlement
6 agreements with that purpose at all.

7 Q. Now, you nonetheless believe that the opinion
8 you've stated here is correct.

9 A. Yes.

10 Q. But you've had theories before, haven't you,
11 that you believed were -- or opinions before that you
12 believed were correct and that turned out not to prove
13 out in practice?

14 A. Theories, yes.

15 Q. And is there one that you had called consistent
16 conjectures?

17 A. Yes, although --

18 MR. KADES: Objection, Your Honor. I don't see
19 the relevance of a line of questioning going to a
20 theory totally unrelated to this case.

21 MR. NIELDS: I don't actually plan to ask him
22 about that -- the nature of that theory unless he wants
23 to explain it. I simply wanted to make sure we were
24 talking about something concrete and not something
25 simply theoretical.

1 JUDGE CHAPPELL: The objection is overruled.

2 THE WITNESS: Yes, although that was -- that
3 didn't disappear because it was wrong in practice but
4 because it was wrong in theory.

5 BY MR. NIELDS:

6 Q. Well, but some factual information that became
7 known to you after you developed the theory was what
8 persuaded you of that, wasn't it?

9 A. No, it was -- it was theoretical work by
10 others.

11 Q. Well, let me ask you this: You said in the
12 very beginning of your direct testimony when Mr. Kades
13 was leading you through your credentials that you had
14 given depositions in I think you said three other cases
15 previously, litigated cases. Is that right?

16 A. That's right.

17 Q. Now, have you ever had a federal judge write in
18 an opinion that he rejected an opinion of yours given
19 in that case on the grounds that it lacked --

20 MR. KADES: Objection, Your Honor --

21 BY MR. NIELDS:

22 Q. -- lacked factual support?

23 MR. KADES: Objection, Your Honor. This is
24 hearsay.

25 JUDGE CHAPPELL: I'll allow it. It goes to the

1 credibility of the witness. Overruled.

2 Mr. Bresnahan, we appear to be in an
3 objectionary phase. Remember what I told you the first
4 day? If someone's objecting, do not answer the
5 question until I've ruled, okay?

6 THE WITNESS: Yes, thank you.

7 JUDGE CHAPPELL: Thank you.

8 Mr. Nields, go ahead.

9 BY MR. NIELDS:

10 Q. Do you have the question or do you want it read
11 back?

12 A. I would like it read back.

13 (The record was read as follows:)

14 "QUESTION: Now, have you ever had a federal
15 judge write in an opinion that he rejected an opinion
16 of yours given in that case on the grounds that it
17 lacked factual support."

18 THE WITNESS: Yes.

19 BY MR. NIELDS:

20 Q. And would that have been a case called The
21 Package Shop against Anheuser Busch?

22 A. I think so.

23 Q. And did the federal judge, indeed, reject two
24 of your theories -- opinions in that case on the ground
25 that there was no factual support?

1 A. I don't think I had a theory in that case --

2 Q. I changed it -- I changed it to opinion.

3 A. I think that's right.

4 Q. Twice. In other words, there were two opinions
5 that the judge rejected as lacking factual support.

6 A. I think that's right.

7 Q. And then was there another opinion that the
8 judge also rejected, a third opinion on the ground
9 there were numerous errors that permeated each
10 successive revision of your calculations?

11 A. I think that's right, too.

12 Q. Now, I'm going to ask you some questions about
13 risk aversion. Is risk aversion something that
14 economists write about, Professor?

15 A. Yes.

16 Q. And I'm going to put something up on the Power
17 Point again. This is a quote from Paul Samuelson and
18 William Nordhaus in a textbook called Economics. Do
19 you see that?

20 A. Yes.

21 Q. And are these reputable economists?

22 A. Yes.

23 Q. And is Mr. Samuelson indeed a Nobel laureate?

24 A. Yes.

25 Q. Now, the quote says, "A person is risk-averse

1 when the displeasure from losing a given amount of
2 income is greater than the pleasure from gaining the
3 same amount of income."

4 Is that a fair definition of risk aversion?

5 A. It's a -- it's a -- one of the two common
6 definitions for an individual. The other definition I
7 think is more typically used by economists, but they're
8 very, very similar.

9 Q. Okay. Do you want to give us the other
10 definition while we're at it?

11 A. Sure. The -- the -- a person is risk averse if
12 they would turn down a fair bet against something that
13 had the same expected pay-off. That's what I mean by a
14 "fair bet."

15 Q. And to finish that thought, would a risk averse
16 person take a more certain amount of money that was
17 lower than the value of the fair bet?

18 A. Yes.

19 Q. Now, do economists use the concept of risk
20 aversion in analyzing settlements?

21 A. Yes.

22 Q. I've put up another quote on the screen there,
23 and this one is from Richard Posner in a book called
24 Economic Analysis of Law. Do you see that?

25 A. I do.

1 Q. You're familiar with that book?

2 A. I think so.

3 Q. And you're familiar with Mr. Posner?

4 A. Very much so.

5 Q. And is he now chief judge of the United States
6 Court of Appeals for the Seventh Circuit?

7 A. I think so.

8 Q. And in a section of this book, he discusses
9 settlements and negotiations for settlements, doesn't
10 he?

11 A. I don't recall that from this book, but I
12 presume you're quoting it right.

13 Q. And here he says, "A settlement negotiation is
14 an example of decision making under conditions of
15 uncertainty. In such a context, successful completion
16 of the negotiation is affected not only by the costs of
17 negotiation relative to those of the alternative
18 decision-making procedure (here litigation) but also by
19 the parties' attitude toward risk and by --" it looks
20 like a typo there -- "differences between the parties'
21 judgments on the likely outcomes under the alternative
22 procedure."

23 Do you see that?

24 A. Yes.

25 Q. Now, do you agree that the parties' attitude

1 towards risk affects the negotiations?

2 A. Well, it -- it -- I agree that it -- that it
3 can affect the negotiations.

4 Q. Now, did you -- in your main report, did you
5 mention the subject of risk aversion at all?

6 A. No, not as between the parties, though I did
7 mention it with regard to consumers. The parties in
8 what I had read of what the negotiators had said
9 hadn't -- hadn't mentioned risk aversion or any of its
10 cognates.

11 JUDGE CHAPPELL: Professor, what was the last
12 word you said?

13 THE WITNESS: Cognates, I'm sorry, things that
14 were the same.

15 JUDGE CHAPPELL: Okay, your voice trailed off.
16 Can you speak up a little bit?

17 THE WITNESS: I will. Mr. Nields, I'm also
18 having a little trouble -- I think you're having
19 trouble hearing me, and I'm having a little trouble
20 hearing you.

21 BY MR. NIELDS:

22 Q. Okay, I'll try to speak up myself. Can you
23 hear me now?

24 A. Yes, sir.

25 Q. Is it bad when I move away from the mike or --

1 A. No, that's not the issue.

2 Q. I'll just keep the volume up.

3 Now, is it true that a risk averse patent
4 holder would be willing to settle earlier, at an
5 earlier point in time, settle with an entry date of an
6 earlier point in time than the expected entry date
7 under litigation?

8 A. It -- it's true if the expected entry date
9 under litigation is the right risk-free benchmark, then
10 a risk averse patent holder would be able to settle for
11 more competition than that.

12 Q. It would be willing to do so.

13 A. It would be willing. I'm -- yes.

14 Q. Now, I've now put something up on the screen,
15 Professor Bresnahan, that I think you will find
16 familiar. It comes from your rebuttal report at page
17 1, and you say there, "A risk averse patent holder is
18 willing to settle for an entry date that is earlier
19 than the expected entry date under litigation in order
20 to gain certainty."

21 Do you see that?

22 A. Yes.

23 Q. And I take it that is a true statement?

24 A. Yes, under the -- that's right.

25 Q. And that means, I take it, doesn't it, that the

1 risk averse patent holder would be willing to settle
2 for an entry date that provides more competition than
3 the expected entry date under litigation?

4 A. Yes.

5 MR. NIELDS: Your Honor, may I put another
6 board up and question the witness from here?

7 JUDGE CHAPPELL: Yes, you may, and while you're
8 doing that, if someone on the right side, my right side
9 of the room, wants to open a window on this side, feel
10 free.

11 MR. NIELDS: Does that include me?

12 JUDGE CHAPPELL: Anyone who wants to try.

13 BY MR. NIELDS:

14 Q. Can you see this board, Professor?

15 A. Yes.

16 Q. Now, just to explain it, I want you to
17 assume -- Your Honor, can you see it or do I need to
18 move it a little bit?

19 JUDGE CHAPPELL: A little bit to the left,
20 please.

21 MR. NIELDS: To the?

22 JUDGE CHAPPELL: To my left, sorry. Thank you.
23 That's good.

24 MR. NIELDS: Okay.

25 BY MR. NIELDS:

1 Q. Professor, I'm dealing in effect with an
2 assumed settlement that occurs in the year 2000 in a
3 patent infringement lawsuit seeking to enjoin the
4 marketing of the generic until patent expiration, which
5 is 2010. Do you see that?

6 A. I do.

7 Q. And I'm going to ask you to assume that there's
8 a 50/50 chance that the plaintiff will win, okay?

9 A. Okay.

10 Q. And I'm also going to ask you to assume in the
11 same way that you assumed at times in your report that
12 we're not going to worry about the time value of money,
13 okay?

14 A. Right.

15 Q. Do you understand?

16 A. So, let me see if I understand it. So, we're
17 not going to worry about the time value of money --

18 Q. Or the fact that the market might get stronger
19 or weaker as time goes by.

20 A. Right, and the -- and the -- and everyone
21 somehow knows that there's half a chance.

22 Q. Exactly.

23 A. Okay.

24 Q. And so that gives us an expected value of
25 litigation entry date of 2005, correct?

1 A. That's right.

2 Q. Now, just so we understand, a risk averse
3 patent holder might be willing, depending on how risk
4 averse they are, might be willing to settle with an
5 entry date of 2004.

6 A. Right. Let me agree with you, expanding the
7 "depending" a little bit. The -- the -- if all we know
8 is they're risk averse, we can't get to the 2004. They
9 need to -- they need to be adequately risk averse about
10 the particular risk associated with this litigation
11 to -- to go that far to the left. You know, I can't
12 tell from here the things I would need to know to know
13 how risk averse that is or how important this
14 particular risk is to them.

15 Q. Yes, I --

16 A. But I presume when you said "depending," you
17 wanted me to assume that however risk averse that is,
18 they are it.

19 Q. Yeah, and put another way, let's see if we can
20 take this apart. If they are risk averse about this
21 litigation, then we know that they would be willing to
22 settle for a date this side (indicating) of 2005, and
23 depending on how risk averse they are, they might be
24 willing to settle for a date of 2004.

25 A. Depending not only on how risk averse they are

1 but on the nature of the risk associated with this
2 particular uncertainty.

3 Q. Now, Professor, isn't it true that most people
4 are risk averse about most things?

5 A. Acting as individuals, most people are risk
6 averse. I don't know about the "about most things."

7 Q. Well, let's say at least about most economic
8 things.

9 A. No, same answer.

10 Q. I'm putting up another quote on the screen,
11 Professor, this one again from Mr. Samuelson and Mr.
12 Nordhaus. Do you see that?

13 A. Yes.

14 Q. And it says, "People are generally risk-averse,
15 preferring a sure thing to uncertain levels of
16 consumption; people prefer outcomes with less
17 uncertainty and the same average values."

18 Do you see that?

19 A. Yes.

20 Q. Do you agree with that?

21 A. Yes.

22 Q. Okay. Now I'm putting up another quote. Do
23 you see that?

24 A. I do.

25 Q. This is from a Mr. Scherer in a textbook

1 Industrial Market Structure and Economic Performance.

2 Do you see that?

3 A. I do.

4 Q. And is Mr. Scherer an economist?

5 A. Yes.

6 Q. And is he a reputable economist?

7 A. Yes.

8 Q. Now, he is now talking not just about people
9 but about business managers, isn't he?

10 A. I believe so.

11 Q. And he says, "Only the decision maker who
12 attaches no significance whatsoever to avoiding risk
13 will always choose alternatives with the highest
14 best-guess payoffs. And such managers, empirical
15 studies suggest, are rare."

16 Do you see that?

17 A. I do.

18 Q. Do you agree with that statement?

19 A. Yes. The -- the -- the -- well, the first part
20 of it is simply and logically true. It's the -- it's
21 the definition of having some risk aversion, and I -- I
22 think I agree also with Scherer that individuals are
23 rarely risk-neutral.

24 Q. Well, I don't think you've quoted him
25 accurately, have you? You substituted the word

1 "individuals" for the word "managers." Well, how about
2 answering the question the way he put it?

3 A. Oh, no, as managers, yeah, I agree with that,
4 too. Rarely risk-neutral.

5 Q. Okay, I'm going to ask you questions on a
6 slightly different topic. The parties to a litigation
7 and to a settlement negotiation are not necessarily
8 always neutral, are they?

9 A. I'm sorry, what do you mean by "neutral"?

10 Q. Well, their judgments are affected by their --
11 by their interest and their bias in various ways,
12 aren't they? I'll withdraw that question if it's too
13 hard.

14 A. No, I'm --

15 Q. I --

16 JUDGE CHAPPELL: Gentlemen, gentlemen, one at a
17 time.

18 MR. NIELDS: I'm sorry.

19 THE WITNESS: I am confused at this point.

20 BY MR. NIELDS:

21 Q. All right. Parties frequently are optimistic
22 about their chances of winning a litigation. Isn't
23 that true?

24 A. That's -- that's my understanding, yes.

25 Q. And frequently both parties are optimistic.

1 A. Well, are relative to one another, yes.

2 Q. And you in your report hypothesized or dealt
3 with an example in which each party thought they had a
4 two-thirds probability of winning the case.

5 A. I think that's right.

6 Q. And obviously they can't both be right.

7 A. That's right.

8 Q. They could both be wrong.

9 A. Yes.

10 Q. The truth could lie somewhere in between?

11 A. Yes.

12 Q. It could lie at where one of them has -- has
13 predicted?

14 A. That's right.

15 Q. And it could lie outside of that.

16 A. If there is -- if there is a truth, yes.

17 Q. So that if two parties each think they have a
18 two-thirds chance of winning -- well, first of all,
19 it's going to be difficult for there to be a
20 settlement, right?

21 A. Typically so.

22 Q. And it's a little bit hard under those
23 circumstances, isn't it, to say what the expected value
24 of the litigation is.

25 A. The -- the parties have a view of that, each

1 party has a view of that. It's I think hard to say --
2 I mean as a factual matter, you know, it's hard to say
3 anything else. Those would be in my view the best
4 available facts of things that are facts about the
5 expected value of the litigation.

6 Q. But they differ one from another in our
7 example, don't they?

8 A. Yes.

9 Q. And as you said before, you don't know if
10 either of them is right or what the actual
11 probabilities in the litigation are.

12 A. Right, I --

13 MR. KADES: Objection, Your Honor. I think the
14 term "actual probabilities" is vague.

15 JUDGE CHAPPELL: Well, Mr. Kades, before you
16 objected, the Professor answered "right," and then
17 started to answer further.

18 Is that correct, Professor?

19 THE WITNESS: I don't think so.

20 MR. NIELDS: That's what I heard certainly.

21 THE WITNESS: Maybe. I don't know about the
22 "right."

23 JUDGE CHAPPELL: Let's have the court reporter
24 read back the question and any answer you gave.

25 THE WITNESS: Sure, yes.

1 (The record was read as follows:)

2 "QUESTION: And as you said before, you don't
3 know if either of them is right or what the actual
4 probabilities in the litigation are.

5 A. Right, I --"

6 MR. KADES: Your Honor, I'd also object that
7 it's a compound question.

8 JUDGE CHAPPELL: This is the beauty of live
9 transcription. We don't have any doubts. Since the
10 witness had already begun his answer and answered
11 "right," then it appears to me the witness didn't think
12 the question was vague or compound. So, I'm going to
13 overrule your objection and let the witness answer.

14 THE WITNESS: Who's now forgotten the question,
15 sorry.

16 JUDGE CHAPPELL: Then we will have the reporter
17 read back the question.

18 THE WITNESS: Thanks.

19 (The record was read as follows:)

20 "QUESTION: And as you said before, you don't
21 know if either of them is right or what the actual
22 probabilities in the litigation are."

23 THE WITNESS: Right, the -- I don't know, and
24 neither does anybody else. I mean, there isn't any
25 number which can be a fact which is the objective

1 probability.

2 BY MR. NIELDS:

3 Q. Professor, if parties are unable to settle a
4 litigation, either they don't try or they negotiated
5 and are unable to reach an agreement, and the case goes
6 to trial, their expectations aren't going to have any
7 influence on the outcome of the case, are they?

8 A. No, not necessarily.

9 JUDGE CHAPPELL: Professor, I know you're
10 trying to be cooperative, but I'll remind you again,
11 when a question is asked, if you see an attorney start
12 to rise or object, please hold off on your answer.

13 THE WITNESS: Oh, I see. I didn't see that one
14 that time.

15 JUDGE CHAPPELL: Thank you. There wasn't one
16 this time. I'm just trying to make things flow better.

17 THE WITNESS: Oh, I see, I see.

18 JUDGE CHAPPELL: There was one about two
19 minutes ago.

20 THE WITNESS: I understand.

21 JUDGE CHAPPELL: You may proceed.

22 BY MR. NIELDS:

23 Q. The outcome of that trial is going to depend
24 mainly, isn't it, on the intrinsic merits of the case?

25 A. Yes, though it may also depend on the parties'

1 behavior in it, which was why I said not necessarily.

2 Q. And it's going to depend, therefore, on the
3 evidence that's presented and on the relevant law,
4 correct?

5 A. Yes.

6 MR. NIELDS: Your Honor, may I approach the
7 board again?

8 JUDGE CHAPPELL: Yes, you may.

9 BY MR. NIELDS:

10 Q. Now, I am going back to my same example. Do
11 you have it in mind?

12 A. Yes.

13 Q. And I'm going to ask you to assume again that
14 we have a brand name plaintiff who is risk averse about
15 this litigation, okay?

16 A. Okay.

17 Q. And just to make the question clear, I'm going
18 to ask you to assume that they are sufficiently risk
19 averse, the brand name plaintiff, that they would
20 settle at a -- at this date, 2004. Do you understand
21 that?

22 A. I do.

23 Q. Now I'm going to ask you to assume that the
24 generic thinks that it has a 60 percent chance of
25 winning. Do you have that?

1 A. Yes.

2 Q. That would mean that they would accept a
3 settlement with an entry date of 2004, correct?

4 A. Yes, under all of the assumptions we've been
5 making.

6 Q. Okay.

7 A. I think yes.

8 Q. Now, I'm also going to ask you to assume that a
9 panel of neutral patent attorneys has been assembled to
10 evaluate this case from the point of view of the
11 consumers' interest and that they have concluded that
12 it's a 50/50 case, okay?

13 A. The -- they -- I take it they know -- that's
14 kind of other worldly. They know everything that would
15 have happened in the -- well, no, they know all of the
16 evidence in the sense that the attorneys and managers
17 know it?

18 Q. They -- they know -- the case has been fully
19 discovered, it's the day before trial, there's been a
20 full pretrial order, and they know all of the evidence
21 that's going to be presented on both sides.

22 A. And they all -- and these -- so, somehow
23 they've gotten all that.

24 Q. Yep.

25 A. They know as much -- they know as much as the

1 parties know somehow, and they all decide it's 50/50.

2 Q. Correct. Okay, have you got that?

3 A. Yeah, I've got it.

4 Q. Okay. What we're likely to see under that
5 example is a settlement with an entry date at 2004,
6 correct?

7 A. Yeah, I mean, the last part doesn't have
8 anything to do with that. I mean, I was confused for a
9 minute. The existence of the panel doesn't have
10 anything to do with that. It's the parties'
11 expectations which go to that, but -- but --

12 Q. Okay, but just to make my question clear, the
13 brand name company believes it's a 50/50 case.

14 A. Right.

15 Q. But they're risk averse.

16 A. Right.

17 Q. So, the brand name is willing to settle at
18 2004, and the generic is optimistic --

19 A. Right.

20 Q. -- relative to the brand name, and they won't
21 settle for anything other than 2004. My question is,
22 that means under that hypothetical, what we would
23 expect to see is a settlement with an entry date of
24 2004. Am I correct?

25 A. Well, it's -- it's possible that there would be

1 a settlement with that -- with that entry date. I'm
2 not sure we would expect to see it, but it's -- but
3 it's possible under the assumptions of this
4 hypothetical.

5 Q. Professor, I'm going to ask you some questions
6 about monopoly power -- monopoly power.

7 A. Got it.

8 Q. It's true, isn't it, that the fact that a
9 product is covered by a patent does not -- a valid
10 patent, I'm assuming -- does not mean that that product
11 has monopoly power.

12 A. Right, not necessarily.

13 Q. And is it true that the Department of Justice's
14 intellectual property guidelines say that?

15 A. I don't know, but I wouldn't be the least bit
16 surprised.

17 Q. Well, I'm going to put something on the ELMO
18 which will be Section 2.2 of the intellectual property
19 guidelines, which, Your Honor, it's SPX 1058, and it's
20 found at binder 1, tab 8, page 4.

21 Do you have that in front of you?

22 A. I do.

23 Q. And it says, does it not, "The Agencies will
24 not presume that a patent, copyright or trade secret
25 necessarily confers market power upon its owner.

1 Although the intellectual property right confers the
2 power to exclude with respect to the specific product,
3 process, or work in question, there will often be
4 sufficient actual or potential close substitutes for
5 such product, process, or work to prevent the exercise
6 of market power."

7 Do you see that?

8 A. Yes.

9 Q. I should be saying that these are DOJ/FTC
10 intellectual property guidelines.

11 And in addition to the fact that they are --
12 that they are this Agency's guidelines, you would agree
13 with that statement, wouldn't you?

14 A. Yes. Well, I mean, it's a factual statement
15 about what the agencies will do, and I would -- I would
16 agree both literally with it, that this is what the
17 agencies will do, they will not presume this, and agree
18 that they're right.

19 Q. Now, you have defined the market so that K-Dur
20 20 has 100 percent of it, right?

21 A. That's correct.

22 Q. Or I should say had 100 percent of it before
23 September 1, 2001.

24 A. Yes.

25 Q. You define it to include only 20

1 milliequivalent tablets and capsules.

2 A. Correct.

3 Q. And in your testimony about the issue of market
4 power, you relied heavily, did you not, on statements
5 by Schering's managers and other managers in their
6 contemporaneous documents?

7 A. Statements and analysis, yes.

8 Q. And Mr. Kades, I think, led you through certain
9 selected portions of marketing plans, for example, for
10 K-Dur from Schering's files, correct?

11 A. Yes.

12 Q. But those very same documents, in parts of them
13 that you were not shown on direct, demonstrate that
14 Schering defined the market quite differently from you.
15 Isn't that true?

16 A. I'm not sure we're using "defined the market"
17 in the same way. Schering talked about a market which
18 was broader than the one I defined, that's right.

19 Q. And those documents were written for business
20 purposes, weren't they?

21 A. Yes.

22 Q. They were trying to help Schering how to deal
23 with their competitors, weren't they?

24 A. Among other goals, yes.

25 Q. And those documents showed K-Dur with market

1 shares of 30 percent up to maybe 40 percent or just
2 above, correct?

3 A. Yeah, or sometimes of 50-something percent,
4 it -- depending on the way the word "market" was being
5 used and the metric.

6 Q. You mean whether it was dollars or
7 prescriptions?

8 A. That's what I meant by "metric," yes.

9 Q. Yes. And as Schering defined the market in its
10 own documents, other potassium supplements had over 50
11 percent of it in terms of prescriptions, correct?

12 A. Yes, I mean in the sense -- in the sense they
13 used the word "market," that's right.

14 Q. And Schering's documents listed somewhere
15 around 15 or 20 competing products in that market,
16 didn't they?

17 A. I don't know about that 15 or 20. In the sense
18 they used the word "market," they did include other --
19 a number of other products.

20 Q. And some of the documents refer to generic 10
21 milliequivalent forms of potassium chloride as
22 Schering's major competitors. That's a quote, isn't
23 it, "major competitors"?

24 A. I think that's right, at least one document
25 says that.

1 Q. And also referred to the 10 milliequivalent and
2 the 8 milliequivalent version of Klor Con as one of
3 Schering's major competitors. Isn't that right?

4 A. That -- yes.

5 Q. And both Klor Con and generics are low priced
6 potassium chloride supplements, aren't they?

7 A. You mean the Klor Con 10 and the generics? I
8 believe that's right.

9 Q. And indeed, in Schering's documents where they
10 had pie charts showing the market, they showed that
11 combined, Klor Con and the generics had a greater share
12 than Schering. Isn't that right?

13 A. I think that may be right in some years. I
14 mean, certainly there are times when the generics and
15 K-Dur 20 have about the same sales and Klor Con's got
16 substantial sales. So, when you add up those two, they
17 amount to more.

18 Q. More than K-Dur.

19 A. That's what I meant, yes.

20 Q. Now, you mentioned the Microsoft case in your
21 direct testimony, didn't you, Professor?

22 A. I did.

23 Q. Now, are you familiar with the fact that the
24 Court of Appeals in the Microsoft case defined the
25 relevant market to include all products, and I now

1 quote, "reasonably interchangeable by consumers for the
2 same purpose"?

3 A. The -- I'm not -- I don't know that they used
4 that particular phrase. I reacted because the -- I
5 think of defining markets as a thing which economists
6 do rather than courts do.

7 Q. Well, in antitrust --

8 A. But they may -- I'm sorry, they may have been
9 giving that direction to the economics profession.

10 Q. In antitrust cases, the courts do it, don't
11 they?

12 A. I guess the -- we're now off my turf. The --
13 the -- I guess the courts find it or agree to it or
14 something.

15 Q. Well, you've read the Microsoft opinion,
16 haven't you? I think you testified about it on direct.

17 A. Yes.

18 Q. Just so there's no possible dispute about it,
19 I've put page 15 of the Court of Appeals' opinion in
20 Microsoft, and I show you a part under the heading
21 Market definition, and it says, "The relevant market
22 must include all products 'reasonably interchangeable
23 by consumers for the same purposes.'"

24 Do you see that?

25 A. I do.

1 Q. Now, isn't it true that 10 milliequivalent
2 potassium chloride products are reasonably
3 interchangeable by consumers for the same purposes?

4 A. No.

5 Q. Well, did you -- were you here when Dean
6 Goldberg testified the first day of the trial?

7 A. I was.

8 Q. And do you remember him saying that the various
9 potassium chloride products, including the 10
10 milliequivalents, are therapeutically equivalent?

11 A. I do.

12 Q. Now, do you think that consumers can reasonably
13 take two 10 milliequivalent tablets in place of a 20
14 milliequivalent tablet?

15 A. If you limit attention to therapeutic concerns,
16 yes. If you look at the actual behavior in the
17 marketplace by the demanders, no.

18 Q. Well, you wouldn't argue that the pills are
19 used for different purposes, would you?

20 A. The -- the -- not different therapeutic
21 purposes, but they are distinct in demand.

22 Q. They treat the same condition, don't they?

23 A. That's right, that's the therapeutic purposes.

24 Q. And they -- given that therapeutic language,
25 they treat them just as well.

1 A. That's right.

2 Q. The only difference is that some bottles have
3 10 milliequivalent pills and some bottles have 20
4 milliequivalent pills, so you have to take two of the
5 10s to get the same therapy as one 20.

6 A. Right.

7 Q. But you're saying they're not reasonably
8 interchangeable by consumers for the same purpose?

9 A. Consumers don't or demanders here, the demander
10 is a more complex object than just a single consumer,
11 demanders don't so treat them.

12 Q. Well, when Schering brought its K-Dur product
13 onto the market, I think you testified yesterday there
14 were already a bunch of 10 milliequivalent potassium
15 chloride supplements on the market, right?

16 A. I think that's right.

17 Q. And Schering came in, and they didn't just go
18 sell to a whole new bunch of people, did they? They
19 competed with the potassium chloride supplements that
20 were out there before.

21 A. Well, they succeeded in taking demand from
22 them. There was -- that was a -- that was a valuable
23 benefit to consumers, that they had the advantage of
24 this new product.

25 Q. And so Schering persuaded consumers to use

1 their product for the same purpose. Isn't that true?

2 A. Well, for the same therapeutic purpose, yes,
3 though the consumers -- I don't know about immediately
4 began, but by the time I see the behavior, treat them
5 as distinct.

6 Q. Have you heard of a concept called branding?

7 A. I have.

8 Q. And is -- does branding involve frequently
9 marketing and promoting a product?

10 A. Yes, those are the activities -- some of the
11 activities that are done to do branding.

12 Q. And if you do it well, you will get more --
13 you're a company, and you do promoting and marketing
14 for your brand, you will get more sales for your brand,
15 won't you?

16 A. That's right.

17 Q. And in the pharmaceutical industry, isn't it
18 true that not all but most of this promoting and
19 branding activity involves what they call detailing to
20 prescribing doctors?

21 A. I believe that's right.

22 Q. And sales reps, called detail people, that work
23 for Schering, for example, go into the offices of
24 doctors that might prescribe K-Dur, and they educate
25 them about the product, give them free samples, remind

1 them of the product and so forth.

2 A. Yes.

3 Q. And isn't it true that Schering out-spent -- on
4 its K-Dur 20 product, Schering out-spent the rest of
5 the market by a huge margin over the years?

6 A. Well, the -- you mean -- by "market," you can't
7 mean my market. You must mean other potassium
8 chlorides, right?

9 Q. I mean the market as Schering defined it in
10 their own contemporaneous documents.

11 A. Well, Schering certainly spent more, as I
12 understand it, on promotion generally than others.

13 Q. And do you recall any documents saying that
14 Schering had out-spent the rest of the market five to
15 one?

16 A. No.

17 Q. Would it surprise you if that appeared in some
18 documents?

19 A. No.

20 Q. Now, Professor, isn't it true that the
21 competition that exists between a brand name company
22 and its A-B rated generic has some very special
23 features to it?

24 A. Yes. I mean, the -- you mean, the competition
25 between the brand name firm's product and the A-B rated

1 generic to the product.

2 Q. Yes, I should have asked the question that way.

3 A. Yes.

4 Q. Just so we're absolutely clear, we're talking
5 about a brand name, and we're talking about a product
6 that is a generic that has gone to the FDA and
7 established bioequivalence to the brand name and is
8 officially A-B rated to that brand name.

9 A. I understand.

10 Q. Okay. That would include, for example, Klor
11 Con 20 and K-Dur 20.

12 A. Yeah, Klor Con M20 and K-Dur 20.

13 Can we stop for a minute?

14 JUDGE CHAPPELL: Let's hold off at least long
15 enough to see if the firetruck's coming here.

16 (Discussion off the record.)

17 JUDGE CHAPPELL: I don't think there was a
18 question pending, so you can proceed to your next
19 question.

20 MR. NIELDS: Thank you, Your Honor.

21 BY MR. NIELDS:

22 Q. We were talking about the special features of
23 competition between a brand name and its A-B rated
24 generic. Isn't it true that in a sense, the generic
25 can appropriate all of the branding efforts that went

1 into the brand name product?

2 A. No, I don't think that's true.

3 Q. Well, isn't it true that after the A-B rated
4 generic comes into the market, when a doctor prescribes
5 the brand name, the pharmacy may still sell the
6 generic?

7 A. That's right.

8 Q. And in fact, in some states there are laws that
9 require the pharmacy to sell the generic under certain
10 circumstances.

11 A. That's right.

12 Q. So -- and this is a sale that the generic gets
13 precisely because of the fact that Schering got the
14 doctor to prescribe K-Dur.

15 A. Well, or because the doctor prescribed K-Dur.
16 In the case of such a sale, there's a switch to the
17 generic because of that.

18 Q. Yeah. So, if the doctor -- if Schering hadn't
19 done any of its branding efforts and the doctor had
20 prescribed K-Tab or Micro-K, then the generic doesn't
21 get the sale, right?

22 A. That's right.

23 Q. The generic gets the sale because Schering
24 persuaded the doctor to prescribe K-Dur.

25 A. Well, or -- if we're talking about particular

1 sales where the doctor was persuaded, then yes, I agree
2 with you.

3 Q. So, Schering spends the money detailing
4 doctors, and the generic makes a sale.

5 A. In -- with regard to those particular sales,
6 yes.

7 Q. And the generic doesn't need to hire a sales
8 force to go out and persuade the doctor to prescribe
9 the generic in order to make that sale, does it?

10 A. No, not necessarily, not that particular sale.

11 Q. Well, aren't you aware of the fact, Professor,
12 that generic companies generally have tiny sales forces
13 per amount sold, compared to brand name companies?

14 A. I think that's right.

15 Q. And isn't it true that the generic virtually
16 always, if not always, underprices the brand name?

17 A. That's true, too.

18 Q. And they don't have the sales expenses, do
19 they?

20 A. No, they don't have sales expenses.

21 Q. And they don't -- generally speaking, they
22 don't have but a tiny portion of the R&D expenses of a
23 brand name company.

24 A. I think that's right, too.

25 Q. And are you aware that Schering spent a

1 \$1,300,000,000 in research and development in the
2 preceding year?

3 A. What -- I'm not aware of their R&D budget in
4 any year.

5 Q. Okay, you haven't seen their annual report?

6 A. I have, but I haven't focused on that.

7 Q. Now, so, a generic will always underprice a
8 brand name, I think you just said that --

9 A. Or generally, yeah. Almost always.

10 Q. Have you ever heard of a time they didn't?

11 A. The -- I'm remembering discussion of branded
12 generics that have -- but I don't recall the
13 therapeutic category, that had prices close, but I
14 agree with you, it's very rare.

15 Q. And they always take sales away from the brand
16 name, correct?

17 A. Yes.

18 Q. And indeed, by law they would almost have to.

19 A. I think that's right.

20 Q. Now, do you believe that all brand name drugs
21 have monopoly power?

22 A. No, not necessarily.

23 Q. I just want to hold this up now. I think we've
24 just established that when a generic for that brand
25 comes in, it will virtually always underprice and

1 virtually always take sales.

2 A. Right.

3 Q. Under those assumptions, do all brand name
4 drugs have monopoly power?

5 A. If -- if the underpricing and taking sales are,
6 you know, substantial in terms of the impact on the
7 marketplace relative to the competitive constraint
8 available from the other products preexisting before,
9 then yes.

10 Q. All right. So, let me give you an example to
11 see if we understand each other. Let's take a
12 hypothetical category, therapeutic category, with ten
13 brand name products, okay?

14 A. Okay.

15 Q. And they are competing vigorously with one
16 another, okay?

17 A. Okay.

18 Q. And they're therapeutically equivalent, okay?

19 A. Got it.

20 Q. A generic of one of them, or really any one of
21 them, would underprice the brand and take a significant
22 amount of sales away from the brand. Does that mean
23 that the brand had monopoly power?

24 A. Well, they were -- how do I square it? They
25 were -- there were ten therapeutically equivalent

1 products before?

2 Q. Yep.

3 A. Competing vigorously?

4 Q. Yep.

5 A. That -- that doesn't leave -- you know, that's
6 plenty of competitive constraint already, so I don't
7 know how to square it with the rest of the example.

8 Q. Well, the rest of the example is that the
9 generic comes in at a lower price, it has no sales
10 force that it has to pay, it has no R&D budget it has
11 to do, it comes in at a lower price and takes
12 significant share away from the brand.

13 A. The -- the R&D budgets I think doesn't have
14 anything to do with it. The -- the -- you know, if
15 there's already competition among ten firms selling the
16 same -- here it's the same product, there's vigorous
17 competition, the -- the price should already be
18 competed down to the competitive level.

19 Q. Down to the generic level?

20 A. Down to -- down to marginal cost.

21 Q. Let me just make sure I understand what you're
22 saying. Are you saying that if there are ten brand
23 name companies and they are competing vigorously, you
24 would expect to see the price of each of those
25 companies' drugs go down to the generic level?

1 A. If -- if they are very good substitutes, as you
2 say, I would expect them to compete with ten
3 symmetrically posed -- I mean, I don't know if there is
4 such a category -- with ten symmetrically posed firms
5 selling products that are very good substitutes, I
6 would expect with a tremendous amount of competition
7 beforehand.

8 Q. And would you expect the price of those ten
9 companies' products to go down to the generic level
10 even if at the generic level the brand name companies
11 could not pay or cover their cost of developing the
12 product, their cost of marketing the product and their
13 cost of producing the product?

14 A. Well, their costs of producing the product are
15 clearly relevant. When I said the prices would be
16 competed down to marginal cost, that's obviously in
17 there, the cost of developing the product, that's a
18 sunk cost. So, that would I think not affect the
19 situation at all. The cost of marketing the product, I
20 mean, there's nine other very good complete substitutes
21 for this product. Under those circumstances, I would
22 expect marketing expenditures to be -- to be minimal.

23 Q. I don't know that you answered the question.

24 Would you read the question back and then read
25 the answer back, please.

1 (The record was read as follows:)

2 "QUESTION: And would you expect the price of
3 those ten companies' products to go down to the generic
4 level even if at the generic level the brand name
5 companies could not pay or cover their cost of
6 developing the product, their cost of marketing the
7 product and their cost of producing the product?

8 A. Well, their costs of producing the product are
9 clearly relevant. When I said the prices would be
10 competed down to marginal cost, that's obviously in
11 there, the cost of developing the product, that's a
12 sunk cost. So, that would I think not affect the
13 situation at all. The cost of marketing the product, I
14 mean, there's nine other very good complete substitutes
15 for this product. Under those circumstances, I would
16 expect marketing expenditures to be -- to be minimal."

17 BY MR. NIELDS:

18 Q. Let me try the question again, and please
19 explain it as much as you want, but I believe it has a
20 yes or no answer to it either at the beginning or the
21 end.

22 In the example I gave you, ten brand name
23 companies, therapeutically equivalent products,
24 competing vigorously. Is it your testimony that you
25 would expect the price of those products to be competed

1 down to the generic level even if priced at the generic
2 level none of those companies could cover their R&D
3 costs, their cost of production and their marketing
4 costs?

5 A. Yes, because of what I said in the previous
6 answer. I think they will -- let me just say what I
7 think pricing will be there. It will be marginal cost
8 pricing with ten symmetric and equal firms and that in
9 particular that will not be sufficient to cover the R&D
10 costs, because those are sunk and not part of the
11 calculation in the marketplace as you described it.

12 Q. Do you know of any therapeutic category in the
13 pharmaceutical industry in which the competing products
14 competed the price down to the generic level when to do
15 so made it impossible for them to cover their R&D
16 costs, their marketing costs and their costs of
17 production?

18 A. No, and as I said I think in an answer a few
19 minutes ago, I think the assumption of a very high
20 level of competition among the brands, I don't know
21 that there's a therapeutic category to which that
22 applies.

23 Q. Well, let me ask you this question: Are you
24 familiar with what I guess I would call brand name
25 detergents?

1 A. Generally.

2 Q. I mean, you know, there's a product called Fab?

3 A. Yes.

4 Q. There's a product called Cheer?

5 A. Yes.

6 Q. There's a product called Wisk?

7 A. Yes.

8 Q. There's a product called Tide?

9 A. Yes.

10 Q. Now, if you walk into a supermarket, you will
11 find those products on the shelf in the detergent
12 section.

13 A. Yes.

14 Q. Together with several other products, competing
15 products.

16 A. I guess that's right.

17 Q. And if you go into the Giant in this area, you
18 will find a product called Super G, the house brand.

19 A. Yes.

20 Q. Which is sold for a lower price than all of the
21 brand name products.

22 MR. KADES: Objection, Your Honor. The
23 document is -- I don't believe it's been produced to
24 us, and more importantly, it's hearsay. I mean, it
25 hasn't been identified.

1 JUDGE CHAPPELL: Mr. Nields, if you're going to
2 give him facts to set up a hypothetical scenario,
3 that's okay, but we're not going to admit this
4 document.

5 MR. NIELDS: Fine.

6 BY MR. NIELDS:

7 Q. Let's assume that the facts are as I have
8 described them and that the products --

9 JUDGE CHAPPELL: Excuse me. So, the objection
10 is sustained to that extent.

11 BY MR. NIELDS:

12 Q. -- and that the products in a local supermarket
13 are the ones described in this document with the prices
14 opposite them for a -- it's a price per load, in other
15 words, it's, you know, for one running of a washing
16 machine -- of a washing machine.

17 Now, suppose in addition that when the Super G
18 house brand was introduced, it was introduced at a
19 lower price than the brand names, and it took
20 significant share away from at least one of them.

21 A. Just at least one of them?

22 Q. Yeah. Let's assume it took significant share
23 away from all of them, but I'm going to do it one at a
24 time. So, let's assume it took share away from Fab,
25 okay?

1 A. Along with others?

2 Q. For the moment, just Fab, okay?

3 A. Okay.

4 Q. Does that mean that Fab had monopoly power
5 prior to the introduction of the Super G product?

6 A. The -- the -- I don't think I know enough about
7 Fab particularly. I mean, that means that the
8 competition from Super G is valuable to consumers of
9 Fab. So, it -- that's consistent with there being some
10 market power, perhaps some monopoly power.

11 Q. So, you think that there's monopoly power on
12 the part of Fab?

13 A. If the -- if there were the introduction of a
14 lower-priced product that hadn't been there before that
15 took a very substantial -- not very substantial, a
16 substantial amount of sales away from it, yeah, that's
17 market power or monopoly power which is ended by that
18 particular competition.

19 Q. And the Super G product is likely not to be
20 spending the same amount on marketing as Fab, Cheer,
21 Wisk and Tide, correct?

22 A. That would be my expectation.

23 Q. And so you would expect it to come in at a
24 lower price.

25 A. Not particularly for that reason, but I would.

1 I mean, it's a -- it's a house brand. I would expect
2 house brands in general to come in at a lower price.

3 Q. Well, under your definition, Professor, doesn't
4 almost every brand name product in the country have
5 monopoly power?

6 A. Well, if there's -- if there's no available
7 generic for it, I would think that it has more market
8 power, more monopoly power than if a generic were
9 there. I don't know how much it has, but in that
10 sense, yes.

11 Q. Well, actually, my question wasn't whether it
12 had a lot of it or a little of it. My question was
13 whether it had monopoly power.

14 A. If there were no generic, yes, under the --
15 under the assumptions of this, yes. I mean, there's a
16 lot of branded products which are not like this, but
17 with -- we're -- if there was a branded product for
18 which there had no generic and there would be a
19 substantial switch to that generic should it be
20 introduced, then I'd say yes.

21 Q. Now, you define monopoly power at page 2 of
22 your report as the ability to price profitably above
23 cost without constraints from competition. Do you
24 recall that?

25 A. Yes.

1 Q. What cost do you have in mind?

2 A. I have marginal costs in mind or the average
3 marginal costs over the relevant range, to be slightly
4 more precise there.

5 Q. And what costs are included in the marginal
6 costs?

7 A. It depends -- it depends on the situation. Are
8 you asking about the --

9 Q. R&D, for example?

10 A. No, not here.

11 Q. Now, are you aware of the fact that the authors
12 of the leading treatise on antitrust law disagree with
13 that way of handling R&D costs?

14 A. No.

15 JUDGE CHAPPELL: Mr. Nields, you need to remove
16 that document from the ELMO if you're through with it.
17 Thank you.

18 MR. NIELDS: Thank you, Your Honor, and I think
19 I also have to push another button. There we go.

20 BY MR. NIELDS:

21 Q. Professor, I have put a quote from Areeda and
22 Hovenkamp, Antitrust Law up on the screen, and it reads
23 as follows:

24 "Thus, for purposes of inferring power from
25 price-cost margins, we would exclude from variable cost

1 only capital costs (including interest) attributable to
2 investment in land, plant, and equipment; property
3 taxes, other taxes, rents, royalties, and similar items
4 not closely based on output; and depreciation (other
5 than use-based depreciation) on plant and equipment
6 depreciated for accounting purposes over a period of
7 three years or more."

8 And here's the important part: "Depending on
9 the Firm's accounting treatment, variable costs would
10 include either full current research and development
11 and promotional expenditures or the annual depreciation
12 on such 'investments.'"

13 Now, that's a different way of assessing
14 monopoly power than the one you described a moment ago,
15 isn't it?

16 A. Well, that's for -- that's different in two
17 ways. It's about a -- an exercise of inferring power
18 from price-cost margins as a piece of data, and --
19 which I don't do -- and it also -- and, you know, in
20 that context, it -- it adapts certain accounting
21 conventions which are different than the definition I
22 just gave you, yes.

23 Q. So, they would determine monopoly power by
24 whether the product is priced above costs that include
25 not only the cost of production but also the amortized

1 sunk costs in research and development.

2 MR. KADES: Objection, Your Honor.

3 BY MR. NIELDS:

4 Q. Correct?

5 MR. KADES: I think the question
6 mischaracterizes both the quote and the witness'
7 explanation of the quote. This happens to be a quote
8 talking about one particular method of inferring market
9 power.

10 JUDGE CHAPPELL: Well, I understand your
11 objection, Mr. Kades, but if you're correct, then the
12 question that's pending, the witness can clarify and
13 cure the defect you're raising by merely answering it.
14 So, I'm going to overrule the objection and have the
15 reporter read back the question.

16 (The record was read as follows:)

17 "QUESTION: So, they would determine monopoly
18 power by whether the product is priced above costs that
19 include not only the cost of production but also the
20 amortized sunk costs in research and development,
21 correct?"

22 THE WITNESS: No, they -- that's not their
23 definition of market power. That's the way they infer
24 market power in a particular empirical exercise.

25 BY MR. NIELDS:

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1 Q. So, according to them, if they're trying to
2 infer market power by how the price of the product
3 compares to its cost, they would compare the price to
4 the following costs: One, the cost of production; two,
5 R&D; and three, promotional expenses, correct?

6 A. Yes.

7 Q. And that's quite different from what you've
8 been saying, isn't it, Professor?

9 A. No, I do not -- I am not attempting to infer
10 the monopoly power from accounting data. Actually, in
11 general, I think that's a bad idea, though there may be
12 circumstances where you can do it. The -- that's
13 distinct from the question of the appropriate
14 definition of marginal cost for asking whether
15 analytically there's market power.

16 MR. KADES: Your Honor, the witness has been on
17 the stand roughly I think an hour and a half, if we
18 could have a break shortly, I think that that would be
19 appropriate.

20 JUDGE CHAPPELL: Professor, do you think you
21 could endure another 15 minutes?

22 THE WITNESS: I could.

23 JUDGE CHAPPELL: Why don't we proceed until
24 about 3:30, Counselor.

25 MR. KADES: Thank you.

1 BY MR. NIELDS:

2 Q. In fact, Professor, pricing above marginal cost
3 in a differentiated industry does not establish any
4 inefficiency once the need to cover the fixed costs of
5 product design are taken into account. Isn't that
6 true?

7 A. The -- it depends on what you mean by the
8 "taken into account," but I agree. Prices above
9 marginal cost in a product-differentiated industry are
10 not necessarily inefficient.

11 Q. Indeed, you have written that, haven't you,
12 sir?

13 A. I'm sure I have.

14 Q. And K-Dur is in a product-differentiated
15 industry, yes?

16 A. In an industry, I guess that's right.

17 Q. Now, getting back to the special features of
18 competition between a brand name and its generic, it is
19 true, isn't it, that one observes certain phenomena in
20 the competition between a brand name and its generic
21 that one doesn't observe in other contexts?

22 A. It must be true, but I don't know what you
23 mean.

24 Q. All right. First of all, when a low-priced
25 generic enters the market, generally speaking, it does

1 not cause the brand name product to lower its price.

2 A. I think that's, generally speaking, right.

3 Q. And that's unusual, isn't it, Professor? Isn't
4 it -- isn't it normally expected that if a product
5 experiences a lower-priced competitor that takes sales
6 away from it, that the original product will lower its
7 price?

8 A. It's generally expected -- I mean, there's sort
9 of no economic -- general economics which says that,
10 but I think that the -- in the -- certainly in the
11 other industries where I -- that I've studied, the --
12 the pattern is as you say, that the introduction of a
13 competitor lowers the prices of the preexisting
14 products.

15 Q. And another thing that normally happens, isn't
16 it, when a lower-priced competitor comes into a market
17 is that output is expanded?

18 A. Again, I don't know -- I don't know about
19 "normally," but in -- in -- I would expect here and in
20 general.

21 Q. You would expect here and in general that if a
22 low-priced competitor enters a market, output will be
23 expanded?

24 A. Yes.

25 Q. And by output, we mean total sales of the

1 market.

2 A. Well, total quantity.

3 Q. Quantity, not dollars, but units.

4 A. Yes.

5 Q. Now, isn't it true that frequently that doesn't
6 happen in -- when a generic -- low-priced generic
7 enters in the pharmaceutical industry?

8 A. The -- again, I don't know -- I don't know
9 about "frequently." The -- you know, the output
10 expansion depends on the underlying economic
11 fundamentals, and so, you know, whether it happens or
12 whether it's large depends on those fundamentals, and
13 it is my understanding that -- that some studies find
14 that in some products -- I don't know about frequently,
15 I'm really not sure about frequently -- that the total
16 quantity doesn't expand.

17 Q. And indeed, total quantity when a generic comes
18 in frequently goes down, doesn't it?

19 A. I don't know about "frequently," again. I
20 recall it doesn't expand rather than it goes down.
21 There may be some where it goes down.

22 Q. And isn't it true that as a consequence, it is
23 not clear if consumer welfare is enhanced by the entry
24 of a low-priced generic?

25 A. No, I think there's now a consensus among

1 economists that consumer welfare is enhanced by entry
2 of a low-priced generic.

3 Q. I would like you to turn to binder 3, tab 8,
4 page 47. Do you have that in front of you?

5 A. I do.

6 Q. And are you familiar with this article?

7 A. I am.

8 Q. You've cited it even, haven't you, at times?

9 A. Yes, I think so. In my report in particular.

10 Q. And I'm going to read you a passage from page
11 47. It says the following:

12 "One of the aspects of our results that perhaps
13 most surprises us is the ultimate ambiguity they yield
14 regarding the well fair effects of this competition.
15 As we expected when we began our study, generic entry
16 makes a drug available at much lower prices than
17 prevailed during its period of patent protection. Yet
18 it does not significantly lower the prices of branded
19 drugs and, even more importantly, it does not lead to
20 increases in the quantities of the contested drug that
21 are sold. Indeed, quantities may decrease relative to
22 those sold before patent expiration."

23 Do you see that?

24 A. Yep.

25 Q. Do you agree with that?

1 A. I agree that this is what Dick Caves and his
2 colleagues wrote in a paper that really opened up this
3 literature. I don't think that really reflects the
4 current consensus among economists.

5 Q. Professor, do you believe that patent
6 monopolies -- I'm talking about valid patent
7 monopolies -- are good for consumers?

8 A. Neither necessarily good nor necessarily bad.

9 Q. Well, you're aware that patents are covered by
10 our Constitution?

11 A. Yes.

12 Q. And --

13 JUDGE CHAPPELL: Mr. Nields, let's wait for the
14 sirens to pass.

15 (Pause in the proceedings.)

16 JUDGE CHAPPELL: Okay, thank you.

17 MR. NIELDS: Thank you, Your Honor.

18 BY MR. NIELDS:

19 Q. I think the witness answered the question, but
20 I'm not absolutely sure. Did the reporter get an
21 answer?

22 THE REPORTER: Yes, the answer was yes.

23 BY MR. NIELDS:

24 Q. And you're aware that patent monopolies are
25 provided by our statutes enacted by Congress?

1 A. Yes.

2 Q. And I'm going to put in front of you a report
3 by the Congressional Research Service. I believe it's
4 in your binders -- and I'm sorry, Your Honor, I'll need
5 a moment to tell you which. It's binder 1, tab 7.

6 Do you have that in front of you?

7 A. I do.

8 Q. I'm going to ask you about a series of
9 statements in that report starting at page 2 and going
10 over to page 3, and I'm going to ask you whether you
11 agree with them.

12 A. I'm sorry, starting at page 2?

13 Q. Yes.

14 A. Okay.

15 Q. The first full paragraph states, "The patent
16 system is grounded in Article 1, Section 8, Clause 8 of
17 the U.S. Constitution and is intended to stimulate new
18 discoveries and their reduction to practice, commonly
19 known as innovation."

20 Do you agree with that?

21 A. Yes.

22 Q. And innovation is good for consumers, is it
23 not?

24 A. Yes.

25 Q. Then down below it says, "Patent ownership is

1 perceived to be an incentive to innovation, the basis
2 for the technological advancement that contributes to
3 economic growth."

4 Do you see that?

5 A. Yes.

6 Q. Do you agree with that statement?

7 A. Other than the -- other than the "the --" or
8 maybe I don't understand the scope of the "the," I mean
9 the -- patent ownership is one incentive for technical
10 advance, but other than that, I agree with it.

11 Q. I think it says, "Patent ownership is perceived
12 to be an incentive to innovation."

13 A. Right, so the "the basis" is innovation, and
14 then I'm okay with it.

15 Q. Going on, "It is through the commercialization
16 and use of new products and processes that productivity
17 gains are made and the scope and quality of goods and
18 services are expanded."

19 Do you agree with that statement?

20 A. Yes.

21 Q. And it goes on, "Award of a patent is intended
22 to stimulate the investment necessary to develop an
23 idea and bring it to the marketplace embodied in a
24 product or process."

25 Do you agree with that statement?

1 A. I do.

2 Q. And I take it it is a good thing for consumers
3 when ideas are developed into marketable products.

4 A. Yes.

5 Q. And then skipping down a little bit, it says,
6 "This is intended to permit the inventor to receive a
7 return on the expend turn of resources leading to the
8 discovery --" sorry, thank you, I'm getting some help
9 here, my apologies, Your Honor. I'm going to start
10 reading that last sentence over again.

11 "This is intended to permit the inventor to
12 receive a return on the expenditure of resources
13 leading to the discovery but does not guarantee that
14 the patent will generate commercial benefits."

15 Do you agree with that?

16 A. I don't know how to. I don't know what's the
17 antecedent of "this," the first word in this sentence.

18 Q. I think it refers to awarding patents.

19 A. Well, or to -- or -- oh, I see, from the
20 previous sentence. The -- yeah, or to the limited time
21 monopoly, yes.

22 Q. You agree with that?

23 A. Yes.

24 Q. Now I'm going over to the next page. Reading
25 from the top of the first full paragraph, "Studies

1 demonstrate that the rate of return to society as a
2 whole generated by investments in research and
3 development (R&D) leading to innovation is
4 significantly larger than the benefits that can be
5 captured by the person or organization financing the
6 work."

7 Do you agree with that?

8 A. I do.

9 JUDGE CHAPPELL: Mr. Nields, as soon as you
10 finish this line of questioning, let me know.

11 MR. NIELDS: Thank you, I will, Your Honor.

12 BY MR. NIELDS:

13 Q. Then going on, "It is estimated that the social
14 rate of return on R&D spending is over twice that of
15 the rate of return to the inventor."

16 Do you see that?

17 A. I do.

18 Q. And do you agree with that?

19 A. Yes, there are -- I'm not sure that those
20 estimates are right. I think the -- but there are
21 definitely such estimates, and I agree with what was
22 implied by the previous sentence, that it's larger.

23 Q. Okay, regard -- we don't need to quibble over
24 whether -- how much larger, but given that it's larger,
25 I take it among the beneficiaries of this social rate

1 of return are consumers.

2 A. Yes.

3 Q. And going down to the bottom of that paragraph,
4 the last sentence, "The difficulty in securing
5 sufficient returns to spending on research and
6 development has been associated with underinvestment in
7 those activities."

8 Do you agree with that?

9 A. I'm -- I -- I think this is an open question.
10 The -- as a logical statement, I think it follows. I
11 don't think it's -- I don't think it's been established
12 that there's been underestimated -- underinvestment in
13 those activities, but I agree with -- that it follows
14 the logic.

15 Q. And you would agree that we want to avoid
16 underinvestment in such activities?

17 A. Yes.

18 Q. And then going on to the next paragraph, "The
19 patent process is designed to resolve the problem of
20 appropriability. If discoveries were universally
21 available without the means for the inventor to realize
22 a return on investments, there would result a '...much
23 lower and indeed suboptimal level of innovation.'"

24 Do you agree with that?

25 A. Yes.

1 Q. So, patents in that sense are good for our
2 society and good for consumers. Yes?

3 A. Yes, generally.

4 Q. And then going down to the bottom, "The grant
5 of a patent provides the inventor with a means to
6 capture the returns to his invention through exclusive
7 rights on its practice for 20 years from the date of
8 filing."

9 When Mr. Raofield walks up behind me, I know
10 I've forgotten to move the piece of paper. I'll read
11 that part again.

12 "The grant of a patent provides the inventor
13 with a means to capture the returns to his invention
14 through exclusive rights on its practice for 20 years
15 from the date of filing. That is intended to encourage
16 those investments necessary to further develop an idea
17 and generate a marketable technology."

18 Do you agree with that?

19 A. Yes.

20 Q. In light of all of that, if we suddenly had a
21 change in the rules and regardless of whether a patent
22 was valid or not and regardless of whether a generic
23 infringed it, a generic version of any drug, any
24 patented brand name drug, could enter the market six
25 months after the brand name entered it, would that be

1 good for consumers?

2 A. I don't believe so.

3 Q. And is a brand name company fighting to keep
4 its monopoly profits, if it has them, by enforcing its
5 patent, is that consistent with the public interest?

6 A. Yes, generally.

7 Q. So -- and this is hypothetical, I'm asking you
8 to assume this, if Schering had a valid patent and
9 Upsher infringed it and Schering won the case and
10 excluded Upsher for the entire life of the patent, that
11 would be in the public interest?

12 A. I don't know if that would be in the public
13 interest. I mean, in -- in the policy of having patent
14 rights which encourage the development of brand name
15 drugs generally is in -- and of the brand name
16 pharmaceutical companies enjoying their valid patent
17 rights, I think that policy is -- compared particularly
18 to the six-month alternative you just said, in the
19 public interest, but I don't think that implies that in
20 any particular instance that that's better or worse.

21 Q. Well, in the long run, Professor, if companies
22 that owned patents did not enforce them, and do so
23 successfully when they had a right to do so, then that
24 would -- that would undermine all of the policy we've
25 been talking about, wouldn't it?

1 A. Right, I agree. Your long run and my policy
2 are the same concept.

3 Q. Okay. Now, you're aware there's 180-day
4 exclusivity rule, correct?

5 A. Yes.

6 Q. And that rule blocks competition to a degree,
7 doesn't it?

8 A. Yes.

9 Q. Because it -- for the -- for whatever period it
10 is covering, it prevents a second or third or fourth
11 generic from coming into the market, correct?

12 A. Yes.

13 Q. But it encourages the first filing generic to
14 challenge the patent, correct?

15 A. That was -- that was the idea, I think, yes.

16 Q. Is that rule good for consumers?

17 A. I don't know.

18 MR. NIELDS: I'm at a good stopping point, Your
19 Honor.

20 JUDGE CHAPPELL: Mr. Nields, what's your
21 estimate of how much cross you have remaining?

22 MR. NIELDS: Half hour.

23 JUDGE CHAPPELL: What's your degree of
24 confidence for that estimate?

25 MR. NIELDS: Low.

1 JUDGE CHAPPELL: That's a smart answer.

2 Let's take about 15 minutes. We'll recess
3 until 3:55.

4 (A brief recess was taken.)

5 JUDGE CHAPPELL: You may continue, Mr. Nields.

6 MR. NIELDS: Thank you, Your Honor.

7 BY MR. NIELDS:

8 Q. Professor, I've put on the screen a formula
9 taken from your expert report. Do you recognize it?

10 A. Yes, I do.

11 Q. And that's a formula that you devised for
12 calculating the percentage probability that Schering
13 would win the patent case, is that correct, against
14 Upsher-Smith?

15 A. No.

16 Q. What is it, then?

17 A. It's a formula that I devised as part of my
18 calculation I think of the delay resulting from the --
19 from the payment.

20 Q. Well, didn't you -- when you solved this
21 equation in your report, Professor, didn't you solve it
22 for P sub S?

23 A. And I think you can solve it for P sub S, yes.

24 Q. And you did that.

25 A. Yes.

1 Q. And P sub S is the percentage probability of
2 Schering winning the patent case.

3 A. Well, what do you mean -- percentage
4 probability is -- we talked about this in deposition.
5 The percentage probability, is that a number between 0
6 and 100 or 0 and 1?

7 Q. Zero and 100.

8 A. No, I -- I'm looking at the formula, and it
9 looks like it ought to be between 0 and 1 to me.

10 Q. All right, fine, let's change it, and we will
11 amend, if we can, mentally the 37 percent number at the
12 bottom and have it read 0.37.

13 A. Yes. Could I look at the one in my report?

14 Q. Of course.

15 A. Thanks.

16 Q. You'll find it at page 2 to Appendix 1.

17 A. Thanks, got it.

18 Q. Okay. And you solved it there for P sub S,
19 correct?

20 A. Yes.

21 Q. And you actually used 37 percent in your
22 report, correct?

23 A. Yes.

24 Q. So, maybe we'll just leave that at 37 percent
25 and all understand that if we were very rigorous, we

1 would have ended up with 0.37.

2 A. Absolutely.

3 Q. Okay. And here, this -- I'm sorry, I keep
4 getting these confused, but there's that symbol at the
5 left hand with a sub M?

6 A. Right, π sub M.

7 Q. π sub M.

8 A. Economists always write a Greek π for profit.

9 Q. And that represents Schering-Plough's monthly
10 monopoly profits under your assumption, correct?

11 A. Yes.

12 Q. And then you have got π sup B sub C, that
13 represents Schering's monthly duopoly profits under
14 your assumptions, correct?

15 A. Right.

16 Q. And then P sub S represents the percentage
17 probability that Schering wins the patent case,
18 correct?

19 A. Yes.

20 Q. And you solved it and came up with the 37
21 percent, and now I'm going to ask you the various
22 additional assumptions that you needed to make in order
23 to apply this formula.

24 You had to figure out how much money was paid
25 for delay first, right?

1 A. Yes.

2 Q. And you concluded that \$60 million was paid for
3 delay.

4 A. Right, or for this analysis, assumed it.

5 Q. For this analysis. That actually might be a
6 hard thing to figure out given the positions of the
7 parties here, right?

8 A. Right, this analysis assumes that.

9 Q. Just assumes that.

10 And then you have to figure -- you had to
11 figure out Schering's monopoly profits per month.

12 A. Yes.

13 Q. And then you had to figure out Schering's
14 duopoly profits per month.

15 A. Yes.

16 Q. And then you had to figure out when Upsher
17 would have entered the market if it had won the case.

18 A. Yes.

19 Q. And you had to make some assumption about risk
20 aversion.

21 A. Yes.

22 Q. You assumed there was none, right?

23 A. Right.

24 Q. And then you had to make some assumption about
25 bargaining power as between the parties.

1 A. Yes.

2 Q. And I've forgotten, but you assumed somebody
3 had all of it and that somebody else had none of it,
4 right?

5 A. For this one, it's that Upsher has all of it.

6 Q. And that led you to get this 37 percent
7 probability.

8 A. Yes.

9 Q. Okay. Now I want to go to another formula. I
10 think -- this is mine, correct?

11 A. As far as I know.

12 Q. And you've seen this one before, right?

13 A. Oh, is this the one -- this is the one from my
14 deposition, but here with new symbols?

15 Q. Yeah, we tried to make them a little simpler
16 symbols.

17 A. Got it.

18 Q. And my -- I really have only one question about
19 it. I'm not sure I know the right way to ask this
20 question for a formula person, but with the assumptions
21 of what X equals and the assumptions of what Y
22 equals -- maybe I should state them for the record. X
23 is the percentage probability that the brand name would
24 have won the patent case. Y is the percentage of the
25 remaining life of the patent during which the generic

1 agreed to stay off the market. And there's a footnote
2 to say that we would make the appropriate adjustments
3 to reflect the time value of money, any anticipated
4 expansion or deterioration in the market for the brand
5 name's drug over time, and any delay in entry for the
6 generic that would have occurred even if it won the
7 patent case.

8 With those assumptions, the formula states if X
9 is bigger than Y, then the settlement is
10 pro-competitive. Do you see that all?

11 A. I do.

12 Q. Is that correct?

13 A. Yes.

14 Q. Under those assumptions, if X is bigger than Y,
15 then the settlement is pro-competitive?

16 A. Right.

17 Q. Now, Professor, as I recall from your
18 deposition, you are familiar with -- well, let me ask
19 you this question first. Do you remember the opinion
20 that I showed you earlier on today? I think it was
21 from -- in fact, let's go back to it.

22 It's the one where you compare the settlement
23 assuming there's -- the entrant would only find it
24 worthwhile to settle if paid something. You then
25 compare the settlement that would result, including a

1 payment, to litigating in terms of which would produce
2 more competition.

3 A. Yes.

4 Q. And I think you said earlier that if the case
5 actually went to trial and were litigated, the outcome
6 of that litigation would depend quite a lot on the
7 evidence in the case.

8 A. I believe that's right.

9 Q. You haven't actually looked at the evidence,
10 have you?

11 A. That's correct.

12 Q. Now --

13 A. You mean in the patent case? No, I haven't.

14 Q. Yes, in the patent case.

15 Now, I think you told us that you had some
16 familiarity or had been involved in class action cases.

17 A. One or two.

18 Q. Okay. And I think you said you were aware that
19 when a class action case gets settled, the Court has to
20 make a decision about the fairness of the settlement.

21 A. Yes, I think that's right.

22 Q. And are you aware that when courts do that,
23 they take a look at the merits of the case, and they
24 compare the strength of the plaintiff's case to what
25 the plaintiff got under the settlement?

1 A. Generally, I -- yes.

2 Q. Now, you would agree, wouldn't you, that it's
3 not extraordinarily difficult to get some kind of
4 reasonable answer from a patent lawyer regarding the
5 likely outcome of a litigation?

6 A. Well, some kind of reasonable answer, I think
7 that's right.

8 Q. Now, just a few more questions, Professor.

9 If I may, Your Honor?

10 JUDGE CHAPPELL: Yes.

11 BY MR. NIELDS:

12 Q. Now, you testified on direct about several
13 things having to do with uncertainty and certainty, and
14 I think you told us that prior to settlement, the
15 existence of the litigation created some uncertainty in
16 terms of whether Upsher could enter the market during
17 the period June 1997 to September 2006, correct?

18 A. Yes.

19 Q. Now, just to clarify a point you made during
20 your direct, the settlement got rid of that
21 uncertainty, correct?

22 A. Yes.

23 Q. But it -- it didn't get rid of the uncertainty
24 by replacing it with a monopoly during this uncertain
25 period of time, did it?

1 A. I don't understand -- I'm sorry, you mean
2 during the whole time?

3 Q. Well, the period of time -- the period of time
4 in which there was uncertainty was out to 2006 when the
5 patent expired, right?

6 A. Yes.

7 Q. But when the settlement got rid of that
8 uncertainty, it didn't replace it with a monopoly until
9 2006, did it?

10 A. No, it did not.

11 Q. It replaced it with a period of -- of certain
12 no competition from Upsher-Smith, in part, that's until
13 September 2001, correct?

14 A. Yes.

15 Q. And another period of certain competition from
16 Upsher-Smith, correct?

17 A. That's correct.

18 Q. And that's what we're experiencing today,
19 correct?

20 A. That's correct.

21 Q. Now, from Upsher-Smith's point of view, under
22 litigation, prior to the settlement, they had at least
23 some probability that they would be able to generate
24 cash from their Klor Con M20 product sometime in this
25 period here, this yellow period between 1997 and 2001,

1 correct?

2 A. Yes.

3 Q. And they gave that up as part of the
4 settlement, correct?

5 A. That's right.

6 Q. They gave up any chance that Klor Con M20 would
7 produce any cash during this period.

8 A. Yes.

9 Q. In return for the certainty that it would
10 produce some cash in the period 2001 to 2006, correct?

11 A. That's correct.

12 Q. Now, I want you to assume for the moment that
13 Upsher-Smith cared a lot about getting cash soon, okay?

14 A. Okay.

15 Q. If they did, wouldn't it be true, sir, that
16 even if they thought that September 1, 2001 was a fair
17 entry date given the strength of their patent case,
18 that they still might have been reluctant to settle
19 because they cared a lot about having some possibility
20 of having cash earlier? Isn't that true?

21 A. No, I -- I would calculate -- indeed, did
22 calculate in charts like this the fair entry date in
23 a -- discounted, and here I use Upsher's discount rate.

24 Q. I don't know that we're communicating right
25 now, Professor. I'm going to ask you for the moment, I

1 want you to put aside your thoughts about the license
2 transaction and whether it was for fair value, okay?

3 A. I understand, I understand.

4 Q. All right. We're having a bargain, and I'm
5 Schering and you're Upsher-Smith, okay?

6 A. Right.

7 Q. And we're trying to figure out a fair
8 settlement date given the strength of our cases.

9 A. Right.

10 Q. And we conclude that September 1, 2001 is a
11 fair entry date, okay?

12 A. But do we conclude that ignoring that one of us
13 has a high discount rate, that is to say, values early
14 period cash highly relative to late period cash? That
15 was -- that's where I went off the rails earlier.

16 Q. Well, let's assume for the moment that we
17 ignore that, we simply decide that this is a fair date
18 given the strength of the -- of our two cases.

19 A. Okay. So, what's that mean then?

20 Q. Well, I'm about to ask you another question.

21 A. Oh, I'm sorry.

22 Q. Okay?

23 A. But I meant I can't follow your assumption.

24 Q. You can't follow my assumption?

25 A. No, I don't -- the -- I don't -- I don't know

1 what you just directed me to assume. I guess maybe
2 that's a better way to say it.

3 Q. Well, if you really want me to get complicated
4 about it, I will, Professor. I just want you to -- and
5 I will, if you can't -- if you can't deal with the
6 simple, I'll make it complicated, but I'm asking you to
7 assume that both parties think this is -- let's say
8 this is -- I don't care what we want to call it, 40
9 percent of the way through the patent life, and they
10 say, okay, that about matches the chances that
11 Schering's going to win, all right, or take 50 percent,
12 whichever one you want, but let's just assume the
13 parties agree about the probabilities and they agree
14 that this is a fair date given those probabilities.

15 A. Okay, okay.

16 Q. Can you deal with that?

17 A. I can -- I can assume it. The -- the -- I
18 am -- I'm worried that I've got one of them discounting
19 heavily and the --

20 Q. Well, we are going to deal with that another
21 way if you listen to the question.

22 A. We will deal with that another way. Okay, so
23 this is --

24 Q. Just listen to the questions as they come,
25 okay?

1 A. Okay, I'm going to assume it's fair ignoring
2 discounting or something like that.

3 Q. Yeah, both parties agree that it's a fair date
4 given the strength of the cases.

5 A. Okay, I'm with you.

6 Q. All right? But Upsher cares about getting cash
7 in here, a lot, okay, and Schering knows that. They've
8 been told that. They -- they've heard that. Wouldn't
9 it be perfectly reasonable and expectable that one way
10 of solving that problem would be if Upsher could
11 transfer to Schering some noncash rights and receive in
12 return for them cash now?

13 A. The --

14 Q. Wouldn't that be a perfectly plausible way of
15 solving that problem?

16 A. I don't think so, only if the only source of
17 loans or other capital to Upsher that is cheaper than
18 this very high discount rate is from Schering, only if
19 that's the only one in the whole economy.

20 Q. Professor, isn't this like negotiations 101?

21 A. I don't know what you mean.

22 Q. Wouldn't any good mediator say, that's a very
23 smart way of solving this problem? This is a very good
24 way for the parties to try to come up with a settlement
25 that makes sense? They pick a date that is fair,

1 Upsher has a problem with settling on those terms
2 because they want cash a lot now, and they're giving up
3 the opportunity of getting it under the settlement, so
4 the parties do a fair market value transaction that is
5 a good deal for both parties and solves Upsher's desire
6 for cash?

7 A. The --

8 Q. What's wrong with that?

9 A. Under the assumption that it's a fair market
10 value for both parties and under the assumption which
11 I -- which I don't know how to deal with that you
12 defined fair ignoring the high rated discount, the --
13 you know, if it's a -- if it's a -- if they stop at a
14 fair market value transaction, generally I don't think
15 there's a problem.

16 MR. NIELDS: I have nothing further, Your
17 Honor.

18 JUDGE CHAPPELL: Thank you, Mr. Nields.
19 Any redirect by the Government?

20 MR. KADES: May I have a moment to confer with
21 my colleagues?

22 JUDGE CHAPPELL: You may.

23 (Pause in the proceedings.)

24 MR. KADES: Your Honor, there are other members
25 of the team I need to consult with, and I would request

1 the Court's indulgence to end the day now, I think, and
2 give us time to start early in the morning. I
3 guarantee that if that happens, it will be a
4 significantly shorter redirect than now, than if we do
5 it now. It's late in the day. The witness has been on
6 the stand multiple days now.

7 MR. NIELDS: Your Honor, we would certainly
8 prefer to have this move along. It's -- this witness
9 has been here for a long time, and we are anxious to
10 get the trial moving along. We're apparently going to
11 have another problem later. We think that nothing so
12 new or complex has come up that counsel can't deal with
13 it on redirect now.

14 JUDGE CHAPPELL: Mr. Curran?

15 MR. GIDLEY: Your Honor --

16 JUDGE CHAPPELL: Or Mr. Gidley?

17 MR. GIDLEY: Thank you, Your Honor. We would
18 have the same position. We think that we can conclude
19 court today with the conclusion of this witness'
20 testimony. We've got a number -- I'm sorry, Your
21 Honor, we have a number of people here listening to
22 this witness' testimony, and their time has some value
23 as well.

24 JUDGE CHAPPELL: Mr. Kades, I am going to give
25 you ten minutes. We are going to take a break. We

1 will go off the record for ten minutes, and I need you
2 to proceed or call your next witness.

3 (A brief recess was taken.)

4 JUDGE CHAPPELL: Back on the record, docket
5 9297.

6 Mr. Kades, does the Government have any
7 redirect?

8 MR. KADES: Yes, Your Honor.

9 JUDGE CHAPPELL: You may proceed.

10 REDIRECT EXAMINATION

11 BY MR. KADES:

12 Q. Good afternoon, Professor Bresnahan.

13 A. Good afternoon, Mr. Kades.

14 Q. Let me readjust the microphone for my family
15 genes. I just have a couple of topics I would like to
16 cover with you on redirect.

17 A. Very good.

18 Q. Professor, let's begin with market definition.
19 Why do economists define markets?

20 A. Economists define markets in order to establish
21 the area within which competition will decrease prices.
22 A market is an area within which an addition of
23 competition will lower prices or a subtraction of
24 competition, a lessening of competition, will raise
25 prices. In -- now, in both cases, in both adding

1 competition or subtracting competition, you know, the
2 idea is that it will have a significant impact on
3 prices, but that's the purpose, is to identify an
4 impact of competition.

5 Q. And how did you define the market in this case?

6 A. Using that principle, the -- I defined the
7 market to be -- to be K-Dur 20 and generics for it
8 because it was clear that the competition within that
9 class would lower prices, that the removal of
10 competition within that class of products would raise
11 prices, and in neither case trivial. It would raise
12 them and lower them substantially.

13 Q. What methodology were you using when you
14 defined the market in this particular case?

15 A. The -- I was drawing on a number of methods.
16 The -- the -- I was in particular relying on the
17 general economic literature about -- about this issue
18 and looking at whether -- at a number of indicia in
19 this case about whether these products would be
20 different, and I think most importantly of that was the
21 assessments of market participants about what would
22 happen if competition were to be added or subtracted
23 and what did happen when competition was finally added
24 last fall.

25 Secondly, the market participants'

1 explanation for why that was the case.

2 Q. Are there other ways that economists use in
3 other types of cases, other methodologies to define
4 markets?

5 A. Oh, yes. Depending on the available body of
6 facts and information, there are several.

7 Q. Could you give us an example of the other types
8 of methodologies economists use to define markets?

9 A. Yes. The -- we sometimes do econometric
10 studies. Those are efforts to measure by statistical
11 means which products are particularly close substitutes
12 for which other products. That's a good input into
13 learning where there's market power and where there's
14 not.

15 Another body of methods comes from looking at
16 survey data of what people choose and possibly even
17 what they would choose if competitive conditions were
18 to change.

19 Another one is relying more directly than I did
20 on the content of marketing documents as the main
21 carrier of the -- of the market definition itself.

22 Those are three that come quickly to mind.

23 Q. And tell me this, Professor Bresnahan: Why did
24 you choose the method you did in this case?

25 A. It's directly connected to the most important

1 question, which is how would competitive outcomes
2 change if the particular competition at issue in the
3 case were added or subtracted. The competition issue
4 is whether and when there's a generic for K-Dur 20.
5 The methods I used are right on point -- right on point
6 for that.

7 I think the -- some of the other methods are --
8 would be hard to use in this matter. Econometric
9 methods that try to say what was particularly effective
10 about competition from the generics have to deal with
11 the problem that there hasn't -- you don't have much in
12 the way of sample size, that's a statistical term, that
13 the -- that the number of months at which -- in which
14 there's been competition whose particular force you
15 might want to try to measure econometrically is
16 limited. So, I chose these because they went with the
17 issue at hand and because I thought the others would be
18 weaker.

19 Q. Now, Professor, over the course of the last two
20 days, we've heard a lot about documents you didn't look
21 at or documents that didn't make it into your report.
22 Let's talk about those a little bit.

23 Now, Professor, you said that you did not
24 consider the advertising documents of Schering and
25 Upsher-Plough [sic]. Why didn't you consider those

1 types of documents?

2 A. I don't see their relevance to the -- to the
3 core question, the -- you know, Schering has or had
4 until last summer a valuable monopoly brand name drug
5 position in this market. The -- some of that comes
6 from advertising activities which it particularly does,
7 and others of it -- others of its -- the size of its
8 market and its monopoly power come from its branding
9 activity.

10 I think the question of which of those two
11 sources of its particular market position is -- the
12 sources aren't what's important. What's important is
13 the position.

14 Q. And Professor, we also heard about the fact
15 that there were documents that identified people who
16 make potassium chloride and that you did not refer to
17 these documents in your report.

18 A. The name of the firms --

19 Q. Wait.

20 A. Yes.

21 Q. Let me ask the question.

22 A. Sorry.

23 Q. You've been on there a long time.

24 Why did those sorts of documents that listed
25 who makes potassium chloride, why didn't those -- why

1 didn't you refer to those in your report?

2 A. The competition at issue here is among products
3 not among firms. I pretty much assumed that the
4 sellers of all of these products are pursuing their own
5 self-interests trying to sell their product. The issue
6 isn't the name of the seller. The issue is the
7 competitive constraint offered by the -- by the
8 product.

9 Now, there's -- there's, you know, a -- one
10 important exception to that, which is if the seller --
11 you know, if the product's not a third-party product,
12 such as K-Dur 10. K-Dur 10 is also sold by Schering.
13 So, I looked at that. But as to the firms that sold
14 the other potassium chloride products, I didn't see the
15 relevance.

16 Q. And in your analysis of whether Schering had
17 monopoly power, what's the relevance of the absolute
18 number of companies that have sold potassium chloride
19 in the period 1995 through 1997?

20 A. None.

21 Q. And why does it have no significance?

22 A. The number of companies is -- particularly in
23 the -- in an industry like the smaller formulation of
24 potassium chloride, particularly there, is -- doesn't
25 measure the amount of competition they offer to a

1 different product. What matters is whether their
2 products, taken as a group, would constrain Schering if
3 it were to, as it did historically, raise prices.

4 And the -- and I -- you know, I think you can
5 get the answer to that by looking at two categories of
6 those other products. There's the generics in the
7 smaller formulation, and they are expanding despite a
8 price premium, but the -- a substantial chunk of
9 customers are not switching despite that price premium.
10 And then there's the other brands, which -- which may
11 be priced -- in some cases priced comparable to K-Dur,
12 but they're not -- they're small, and according to the
13 marketing documents, declining. So, they too are not a
14 particularly powerful constraint. You can sort of
15 learn that, as I did, by looking at the class.

16 Q. Professor, we've seen in the last two days
17 quotes from documents in which Schering identified a
18 potassium chloride market or identified generic 8 and
19 10 milliequivalent ones as competitors. Did you
20 consider those statements in forming your opinion that
21 Schering had monopoly power?

22 A. Yes, I did.

23 Q. What significance do those statements have?

24 A. They have limited significance. Any -- let me
25 say why in two ways. First off, it's a very well

1 established piece of economics that any product has
2 some substitutes and particularly if it's elevated its
3 price, it's going to have some substitutes, so that
4 there were some competitors. In the words of a
5 marketer, there are some products to which there's
6 some limited substitution. That's always going to be
7 true, so that -- so, the statement that they're there I
8 think doesn't do very much.

9 You know, and second, the -- the situation was
10 one of -- with the absence of a generic for K-Dur 20.
11 So, if you stand on K-Dur 20 before last September and
12 ask what are the closest available substitutes, whether
13 they're very important constraints or not, whether
14 they're important constraints or not, they're going to
15 have something other than a generic. So that when they
16 looked out from there, under this very standard piece
17 of economics, which there's always some substitution,
18 what they're going to hit is something more -- more
19 distant. So, that's why I put limited weight on those
20 quotes.

21 Q. Professor Bresnahan, how usual or unusual is it
22 for a company with monopoly power to want to try to
23 increase its unit sales?

24 A. It -- I would believe it's -- it's completely
25 usual. I don't know, "usual" is a funny word there. I

1 would expect a firm with monopoly power to want to
2 increase its unit sales, not by cutting price, of
3 course, but by other mechanisms.

4 Q. And throughout all the evidence that you saw,
5 including what's been shown to you over the last two
6 days, was there any evidence that at any time prior to
7 September 1st, 2001 Schering was -- Schering was
8 cutting price to gain unit sales?

9 A. No.

10 Q. And in all the evidence you've seen, including
11 what you've seen in the last two days, have you seen
12 any evidence that any other product, any other
13 potassium supplement, was causing Schering to lose
14 significant sales at a -- because it was pricing below
15 Schering's product?

16 A. No, not significant ones.

17 Q. And in terms of the type of evidence you look
18 for for monopoly power, what sort of evidence is that,
19 those two facts?

20 A. Those facts are very good evidence that there's
21 monopoly power, particularly that there's monopoly
22 power of the -- of the kind which results from the
23 absence of this competition.

24 Q. Now, Professor, there's been -- there was a lot
25 of discussion about the role of net present value in

1 both the analysis of the contingent payments and the
2 licensed products. I'd like to talk to you about that
3 for a moment.

4 And I think -- why don't we take a look at
5 Exhibit CX 341, and Nicole, we are going to want to
6 look at the very last page of that document, 12 -- SP
7 1200253. I believe it's the next one. Nicole, could
8 you just please blow up the -- just the part that says
9 "economic value" and the number? Thank you.

10 Do you remember when you discussed this
11 document with Mr. Gidley yesterday?

12 A. Yes.

13 Q. You talked about the economic value as
14 projected on this forecast as being \$225 million to
15 \$285 million?

16 A. I think it's 265.

17 MR. NIELDS: Sixty-five, Your Honor.

18 BY MR. KADES:

19 Q. I'm sorry, my eyesight is apparently not as
20 good as I'd like to believe it is.

21 Now, assuming the forecast is totally accurate
22 for the moment, then does the fact that it projects a
23 net present value of \$225 to \$265 million show that
24 Niacor-SR was worth a \$60 million noncontingent
25 payment?

1 A. No, the -- a spreadsheet isn't a managerial
2 decision. A spreadsheet's an input into a managerial
3 decision. A manager making a decision whether to make
4 a payment like that, in addition to other payment
5 terms, would make an analysis generally like this, and
6 that would be one of the -- one of the things that the
7 manager would take into account, deciding whether to
8 undertake an activity or not. It isn't -- it just
9 isn't true that in any firm I've ever spent time with,
10 what happens is that if the spreadsheet comes out
11 positive, you do it. I mean, that's -- that's one of
12 the ingredients in a decision which is -- which is
13 based on a manager's assessment of many things about
14 the firm's position, including that.

15 Q. What does matter to determine whether the
16 Niacor-SR license was worth a \$60 million noncontingent
17 payment?

18 A. The -- the -- what matters is -- is whether
19 that's the kind of payment that Schering would have
20 made to -- for an opportunity of that kind on a
21 stand-alone basis on the one side, the Schering side,
22 and on the Upsher side, whether they could have
23 obtained that kind of payment, up-front, noncontingent
24 payment, in that manner -- in that amount from the
25 market for the -- for the licenses.

1 Q. Professor Bresnahan, do you remember yesterday
2 on cross Mr. Gidley asked you about the other products
3 that were in the license deal besides Niacor-SR?

4 A. Yes.

5 Q. What have you seen that relates to what
6 Schering valued the other products at in terms of
7 willingness to make a noncontingent payment?

8 A. Well, I haven't done any valuation of them
9 myself, but I remember what Mr. -- what Mr. Kapur said
10 about it.

11 Q. I'm showing you what's been marked -- if you
12 could bring up CX 1510, I believe if you could turn to
13 page 86.

14 Just for the record, Your Honor, this is the
15 investigational hearing of Mr. Raymond Kapur. It
16 was -- the testimony was taken July 21st in the year
17 2000.

18 JUDGE CHAPPELL: Thank you.

19 BY MR. KADES:

20 Q. Professor Bresnahan, who is Mr. Kapur?

21 A. Mr. Kapur is the -- is a Schering official in
22 the generic business. He was -- he was a participant
23 in the negotiations with Upsher.

24 Q. And what sort of role did he have in those
25 negotiations?

1 A. I think he was the primary negotiator for
2 Schering.

3 Q. And what did he say about the other products
4 besides Niacor-SR?

5 A. Well, I've asked Nicole to highlight it here.
6 He was asked, "Were there no payments discussed on
7 cholestyramine --" I can't pronounce these products
8 very well " -- pentoxifylline or the potassium
9 chloride?"

10 Those are the various Klor Cons licensed back
11 to Schering.

12 He said, "Right," there were no payments
13 discussed.

14 "Was the 70 million just for Niacor?"

15 He said, "Pretty much."

16 Q. And the 70 million refers to Niacor, what does
17 that relate to?

18 A. That's the -- I think the sum of the \$60
19 million plus another \$10 million in milestone payments,
20 I think.

21 MR. KADES: I'm sorry, Your Honor, this will
22 just take a moment.

23 JUDGE CHAPPELL: Okay.

24 BY MR. KADES:

25 Q. Professor Bresnahan, do you need more water?

1 A. I'm fine, thank you.

2 MR. KADES: Your Honor, the next document I'm
3 going to talk about is -- I believe is an in camera
4 document. It is an AHP document.

5 JUDGE CHAPPELL: At this time I'm going to have
6 to ask the public to leave the courtroom unless you are
7 covered by the protective order in this case. We're
8 getting ready to look at a confidential document.

9 (The in camera testimony continued in Volume 6,
10 Part 2, Pages 1249 through 1253, then resumed as
11 follows.)

12 THE WITNESS: I'm with you.

13 BY MR. KADES:

14 Q. Okay, Professor Bresnahan, in the no generic
15 entry scenario, what is the market price of generic
16 K-Dur and all of its -- and its generic equivalents?
17 How would you figure that? Let's start there.

18 A. Well, the -- I would calculate, if I made the
19 same calculation as Mr. Gidley led me through, I would
20 divide the dollar sales by the unit prescriptions to
21 get dollars per prescription, which is a measure of
22 average selling price.

23 Q. Okay. And what are the total dollars?

24 A. Well, in -- you know, in January, for January
25 1997, for example, they're forecasted to be \$17.274

1 million. So, that's my numerator if I were to do that
2 month. And the prescriptions for that month are
3 forecasted to be 920,000.

4 Q. Okay. And let's just use as the month, we are
5 going to use December, okay?

6 A. Use December?

7 Q. Yes.

8 A. Oh, okay. Okay, I'll use December.

9 Q. So, if you were -- what are the numbers you're
10 using to calculate the price -- the prescription price
11 of K-Dur 20 in the no generic entry scenario for
12 December 1997?

13 A. Sure, I'm using the \$18.164 million for the
14 dollar sales and the 966 for the -- 966,000
15 prescriptions. In fact, I think those may be numbers
16 that I used the other day.

17 Q. What do you get as the --

18 A. About \$18.805 per prescription.

19 Q. And in the no generic entry, is there any
20 generic price we have to factor in?

21 A. No.

22 Q. Now let's move to the generic -- under the
23 generic impact, the market price for K-Dur 20. Now,
24 what does that -- what do you need to calculate the
25 market price?

1 A. To calculate the market price, I need the brand
2 price and the generic price, and I need to weight them
3 according to their relative unit sales. So, I need to
4 know the -- the brand price, which will be similar to
5 this number, the generic price, which will be lower,
6 and then I will calculate a weighted average to get the
7 average selling price in the marketplace, and that will
8 be comparable to the number with no generic.

9 Q. And let's start with the brand price for
10 December in the generic impact scenario.

11 A. Very good.

12 Q. What are the numbers you are using for the
13 calculation?

14 A. I'll use the December monthly sales for K-Dur,
15 it's the bottom of that column, Nicole, if you would,
16 \$9,736,000, and I'll divide it by the adjacent units
17 and prescriptions, the 518.

18 Q. Okay. What do you get from that calculation?

19 A. I get \$18.795, so again about \$18.80 per
20 prescription.

21 Q. Now, moving to calculating the generic price,
22 do you see on the bottom there's an assumption that
23 says, "Warrick assumes 50 percent of lost K-Dur volume
24 at 50 percent of the price?"

25 A. Yes.

1 Q. Would it -- given that assumption, would it be
2 reasonable to assume the generic price of all the
3 generic competitors would be 50 percent of brand?

4 A. Yes.

5 Q. So, let's use the -- as the assumption for the
6 generic price that it's 50 percent of the brand price.

7 A. Sure. I'm going to do that calculation now.

8 So, that gives me 9.397 or about \$9.40.

9 Q. And you said to get a market price, we would
10 have to weight those by the relative number of
11 prescriptions, and what do we have for the brand
12 prescriptions?

13 A. I already looked at that. We have the 518,000.

14 Q. Now, earlier today Mr. Nields talked to you
15 about a phenomenon that once there's generic entry,
16 total prescriptions either remain flat or go down. So,
17 why don't we take the assumption that the total number
18 of prescriptions is the same for the generic or
19 nongeneric, just in the generic it's split between the
20 two. Did you follow that?

21 A. Yes.

22 Q. So, how would you calculate the number of
23 generic units?

24 A. Well, the -- I happen to recall that the person
25 who wrote on this by hand has already made that

1 assumption and done that calculation, and that's the
2 448 number there next to the 518. So, that's already
3 done. What they did was what I would have done, which
4 is subtract the brand from the total market. Now, the
5 only total market I know here is the market under the
6 generic -- under no generic competition, which is the
7 966.

8 Q. Now, when you -- when you do your weighted
9 average, what's the calculation that you're performing?

10 A. I'm going to be taking an average of \$9.40 and
11 \$18.80, so I'm going to get a number in between those
12 two. The weights are going to be proportional to the
13 448 and the 518. They're going to be proportional to
14 the unit sales. So, since here the brand sales are
15 more -- a little more than half, the -- my calculation
16 is going to end up a little bit more than halfway up
17 from the \$9.40 to the \$18.80. That's the calculation.

18 Q. Why don't you perform that calculation.

19 A. For this purpose, I'm going to write on a piece
20 of paper, if I may. I'm writing the -- and you all
21 have the transcript in front of you, so remind me if I
22 make a mistake. I'm writing the 9.4, which is the
23 generic price, and the 18.8, \$18.80, which is the brand
24 price. Now I'm going to calculate the weights. I'm
25 dividing the 448 generic unit sales by the 966, and I

1 get a weight of 0.46, 46 percent of the units are
2 generic units.

3 So that tells me that the rest, 54 percent of
4 the units, 0.54, are at the brand price, okay? So,
5 I've now got an equation in front of me -- or not -- an
6 expression, which is 0.46 times 9.4 plus 0.54 times
7 18.8, and I'm going to attempt to do that calculation
8 now with this calculator.

9 Which is a calculator that's unfamiliar to me,
10 so I don't know how to do a memory recall from it. I'm
11 going to do it again more slowly. My apologies.

12 Q. Professor, why don't you just tell us the
13 results as you're getting them and we can write them
14 down and we can serve as your memory function.

15 A. Yes, thank you. For the 0.46 times the 9.4, I
16 get 4.324, and for the 0.54 times the \$18.80, I get
17 10.152, so when I add them up, I get 14.476. So, as I
18 said, it's a little under halfway up from \$9.40 up to
19 \$18.80. It's just about in the middle. And what that
20 is is the -- you know, on the same basis, average
21 selling price after generic entry, which is on the
22 assumptions that were made to prepare this document
23 a -- you know, a little under \$15 -- \$14 -- a little
24 under \$14 and a half as compared to the \$18.80 absent
25 generic entry.

1 Q. Okay. And roughly how much are consumers
2 saving in the month of December in the generic entry --
3 in the generic impact scenario versus the no generic
4 impact scenario?

5 A. Well, they're now paying only an average of the
6 14.476 -- give me a moment. They are -- they're saving
7 a little over \$4 million that month if I've -- if I've
8 calculated it right. Instead of paying \$18.8 each for
9 the 966,000 prescriptions, they're paying \$14.476, and
10 that's about \$4 million less, \$4.18 million less.

11 Q. And assuming that's the amount consumers save
12 each month, how much would it cost them if there was an
13 agreement that delayed entry for a year?

14 MR. GIDLEY: Objection, Your Honor. This
15 document doesn't provide the foundation for making this
16 calculation. This document talks about K-D market
17 share. For all we know it combines K-Dur 10 and K-Dur
18 20.

19 MR. NIELDS: I have an additional objection,
20 Your Honor, when the Court is ready.

21 JUDGE CHAPPELL: Well, I'm going to sustain
22 this objection pending a better foundation.

23 Let me hear you, Mr. Nields.

24 MR. NIELDS: It doesn't seem to me, Your Honor,
25 that this is rebuttal. It's not clear to me what it is

1 that's being rebutted here. This just sounds like an
2 additional piece of the original direct.

3 JUDGE CHAPPELL: Mr. Kades?

4 MR. KADES: Your Honor, let me respond to the
5 second objection first. I believe on direct Mr. Gidley
6 suggested that there was really no impact because the
7 brand didn't change its price. What I'm walking
8 Professor Bresnahan through is the analysis that shows,
9 using the assumptions in this document, there is a
10 significant impact to consumers. He just said that
11 there was a \$4.4 -- an over \$4 million impact on one
12 month.

13 JUDGE CHAPPELL: Okay, I am going to overrule
14 the objection that it's not proper rebuttal, but I'm
15 sustaining the one on foundation. You're going to have
16 to lay a better foundation for the question that you
17 just asked. It's too broad.

18 MR. KADES: I'll withdraw it, Your Honor.

19 JUDGE CHAPPELL: Mr. Kades, it's after 5:30.
20 Let me know when you finish the current line of
21 questioning.

22 MR. KADES: Your Honor, I just finished the
23 current line of questioning.

24 JUDGE CHAPPELL: Okay, we're in recess until
25 9:30 tomorrow morning.

1 (Whereupon, at 5:35 p.m., the hearing was
2 adjourned.)
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3 CASE TITLE: SCHERING-PLOUGH/UPSHER-SMITH

4 DATE: JANUARY 30, 2002

5

6 I HEREBY CERTIFY that the transcript contained
7 herein is a full and accurate transcript of the notes
8 taken by me at the hearing on the above cause before
9 the FEDERAL TRADE COMMISSION to the best of my
10 knowledge and belief.

11

12 DATED: 1/31/02

13

14

15

16 SUSANNE BERGLING, RMR

17

18 C E R T I F I C A T I O N O F P R O O F R E A D E R

19

20 I HEREBY CERTIFY that I proofread the
21 transcript for accuracy in spelling, hyphenation,
22 punctuation and format.

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